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Supreme Court of the United States

OCTOBER TERM, 1961

No. 87

MANAGED FUNDS, INCORPORATED,
PETITIONER,

vs.

J. JOHN BROUK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 6, 1961
CERTIORARI GRANTED JUNE 19, 1961

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MISSOURI

EASTERN DIVISION

Civil Action No. 59 C 162 (3)

MANAGED FUNDS, INCORPORATED, a corporation, Plaintiff,

vs.

SLAYTON ASSOCIATES, INC., a corporation, SLAYTON & COMPANY, INC., a corporation, MUTUAL FUND DISTRIBUTORS, INC., a corporation, HILTON H. SLAYTON, HOVEY E. SLAYTON, JAMES S. STUBBS, HAROLD W. SMITH and LEO MODEL, ROLF R. ROLAND, FRITS MARKUS, ROBERT ROSENBERG, WALTER H. BERTON, WALTER S. MORRIS, ERWIN WOLFF, STEPHEN M. JAQUITH, ELLIOTT D. FOX, FRANK L. THOMPSON and HERMAN H. STONE, each individually and as a member of a co-partnership, doing business under the name of MODEL, ROLAND & STONE, and JACOB BAKER, LLOYD E. BOAS, J. JOHN BROUK, CHARLES E. BROWN, EDWIN J. CUNNINGHAM, ROBERT A. HICKS, JOHN C. JESTER, JAMES J. MULLEN, JR., JEFFERSON J. REBSTOCK, EARL R. RICE, W. MUNRO ROBERTS, JR., and GEORGE H. SHIELDS, III, Defendants.

AMENDED COMPLAINT IN NO. 59 CIVIL 162 (3)—
Filed October 23, 1959

Count I.

Comes now the plaintiff, and as and for its first claim for relief against the defendants, and each of them, states as follows:

1. This action arises under and by reason of the defendants' violation of the Investment Company Act of 1940, [fol. 2] 54 Stat., Sections 789-847, 15 U. S. C. 80a, and the rules promulgated by the Securities and Exchange Commission thereunder.

2. The plaintiff is a corporation, registered under the Investment Company Act of 1940 and engaged in the sale of shares of its stock to the general public through underwriters, distributors, dealers and salesmen.

3. The defendant Slayton Associates, Inc., is a corporation principally engaged in serving as an investment adviser and manager of investments.

4. The defendants Slayton & Company, Inc., and Mutual Fund Distributors, Inc., are corporations each engaged in business as registered brokers or dealers in investment securities.

5. The defendants Hilton H. Slayton and Hovey E. Slayton were at all times mentioned herein until May 3rd, 1959, the principal managers, officers and directors of the plaintiff, were also at all such times the sole stockholders, principal officers and directors of defendant Slayton Associates, Inc., and also the principal and controlling stockholders, principal officers and directors of the defendants Slayton & Company, Inc., and Mutual Fund Distributors, Inc.

6. The defendant Jacob Baker was a director of the plaintiff from a date prior to the year 1952 up to and including the 21st day of October, 1955; defendant Lloyd E. Boas was a director of the plaintiff from November 23, 1954, to and including June 12, 1959; defendant J. John Brouk on June 28, 1955, became a director of the plaintiff, and ever since has been and now is a director of plaintiff; defendant Charles E. Brown was a director of the plaintiff from November 27, 1953, to and including May 3, 1954; defendant Edwin J. Cunningham was a director of the plaintiff from a date prior to the year 1952 up to and including June 28, 1955; defendant Robert A. Hicks was a director of the plaintiff from November 18, 1957, to and including May 3, 1959; defendant John C. Jester was a director of the plaintiff from June 23, 1952, to and including November 27, 1953; defendant James J. Mullen, Jr., on May 21, 1954, became a director of the plaintiff, and ever since has been and now is a director of [fol. 3] plaintiff; defendant Jefferson J. Rebstock, on June 23, 1952, became a director of the plaintiff, and ever since

has been and now is a director of plaintiff; defendant Earl R. Rice was a director of the plaintiff from a date prior to the year 1952, and ever since has been and now is a director of plaintiff; defendant W. Munro Roberts, Jr., on June 28, 1955, became a director of the plaintiff, and ever since has been and now is a director of plaintiff; defendant George H. Shields, III, was a director of the plaintiff from June 23, 1952, to and including November 23, 1954; and all of the defendants hereinabove in this paragraph named are, for convenience, sometimes hereinafter referred to as the "outside directors". On information and belief, the said outside directors, and each of them, had either actual knowledge of the acts hereinafter complained of, or, in the performance of the duties and obligations imposed upon them by law as directors, and by the exercise of ordinary care and diligence in the performance of such duties and obligations, would have acquired knowledge of such acts, and hence are chargeable with having constructive knowledge thereof.

7. The defendants, Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone are members of a co-partnership, doing business as Model, Roland & Stone, and said partnership is principally engaged as a registered broker-dealer, and member of the New York Stock Exchange, in the sale or purchase of securities.

8. The defendant Stephen M. Jaquith is a partner in the partnership of Model, Roland & Stone, and was at all times mentioned herein either an employee of or partner in said partnership.

9. The defendant James S. Stubbs is an employee and representative of the partnership of Model, Roland & Stone, and a former business associate of the defendants Hilton H. Slayton and Hovey E. Slayton and former director of the plaintiff.

10. The defendant Harold W. Smith is an employee and representative of the partnership of Model, Roland & Stone, and is a brother-in-law of defendant Hovey E. Slayton.

[fol. 4] 11. All of the defendants herein had actual or constructive knowledge of the provisions of the Investment Company Act of 1940, and the rules promulgated by the Securities and Exchange Commission thereunder.

12. In accordance with the Investment Company Act of 1940, and the said applicable rules, plaintiff's announced and published policy in offering its shares, of all series, for sale has been that plaintiff's primary purpose is to provide for capital growth, and that to the extent consistent with such policy plaintiff would seek reasonable income on its investments, which net investment income and any realized profits on the sale of securities in its portfolio would be distributed quarterly. Statements of this policy were contained in the reports and prospectuses required to be filed with the Securities and Exchange Commission under the Investment Company Act of 1940, and the prospectuses required to be filed under the Securities Act of 1933 and distributed to the public in connection with the sale of plaintiff's shares.

13. In accordance with the provisions of the Investment Company Act of 1940, and the said rules thereunder, plaintiff was required to file certain annual and quarterly reports, and to therein truthfully state certain information with reference to the affairs and operations of plaintiff, and such information as is required must consist of true statements of material facts, and said law further requires that there be no omission to state in such reports facts necessary in order to prevent the statements which are made from being materially misleading.

14. The defendant Slayton Associates, Inc., by contract dated August 15, 1952, was employed by plaintiff as an investment adviser, and by such contract said defendant was obligated to furnish plaintiff with such advisory, research and statistical service with reference to investments as were in accordance with plaintiff's policies, and in return therefor said defendant was paid an annual fee in the amount of one-half of one per cent (½ of 1%) of the total asset value of plaintiff's assets.

15. On December 1, 1953, defendant Slayton Associates, Inc., entered into a contract with defendant Jaquith [fol. 5] whereby defendant Jaquith was employed as investment counsellor and manager of the securities portfolio of plaintiff, and thereafter defendant Slayton Associates, Inc., while still receiving a fee for such services pursuant to its contract with plaintiff, unlawfully delegated its duties thereunder to defendant Jaquith and abdicated its duties and responsibilities under said contract. By provisions of said contract between the defendant Slayton Associates, Inc., and defendant Jaquith it was agreed that the defendant Jaquith, or such person, persons or firms as he might designate, would be paid, beginning December 1, 1953, the annual sum of $50,000.00 for five years, and be paid for the succeeding five years a minimum of $35,000.00, said minimum payments to apply against brokerage commissions which defendant Slayton Associates, Inc., would direct to defendant Jaquith or his designees.

16. Pursuant to the contract mentioned in the preceding paragraph the defendant Jaquith designated the partnership of Model, Roland & Stone as the recipient of the commissions mentioned therein, and the defendants Hilton H. Slayton, Hovey E. Slayton and Slayton Associates, Inc. thereupon directed plaintiff's brokerage business to the defendant Jaquith and Model, Roland & Stone, for which they have received brokerage commissions in excess of $1,500,000.00.

17. The defendant Jaquith and Model, Roland & Stone, at the direction of defendant Slayton Associates, Inc., paid annual commissions to each of the defendants Smith and Stubbs in excess of $50,000.00 per year, no services having been performed by either of said defendants in return for such payments.

18. After advisory service was furnished by defendant Jaquith and Model, Roland & Stone pursuant to the contract between defendant Slayton Associates, Inc. and defendant Jaquith, plaintiff's basic policy of "capital growth" was not followed, but, on the contrary, a policy was fol-

lowed in handling the portfolio of plaintiff, which would maintain a predetermined amount of distributions on plaintiff's shares from year to year, and if the income from the portfolio investments was not sufficient therefor to realize [fol. 6] gains for such distribution from the sale of plaintiff's securities, and the policy followed permitted the underwriters of said securities, the defendants Slayton & Company, Inc., and Mutual Fund Distributors, Inc., to make greater sales of plaintiff's shares and thereby obtain greater commissions and profits.

19. The policy followed, as set forth in the preceding paragraph, resulted in gross mismanagement of, and loss and damage to, the investment portfolio of plaintiff, and greatly increased the brokerage commissions for the purchase and sale of the portfolio securities of plaintiff, and resulted in greater payments under the contracts between the defendants Slayton Associates, Inc. and Jaquith, all without a corresponding or any benefit to plaintiff.

20. Plaintiff was caused to place reciprocal brokerage business on transactions in plaintiff's portfolio securities with broker-dealers who sold plaintiff's shares, to place such brokerage business with securities firms who supplied, without cost, certain publications and communication facilities to defendants Slayton & Company, Inc., Mutual Fund Distributors, Inc. and Slayton Associates, Inc., and to satisfy obligations for merchandise and services rendered to defendants Slayton & Company, Inc., Mutual Fund Distributors, Inc. and Slayton Associates, Inc., by directing to the suppliers thereof such brokerage business.

21. Plaintiff further states, on information and belief, that the defendants committed, or with actual or constructive knowledge, as hereinabove set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940, in that, inter alia,

(a) the plaintiff was operated, managed, and its portfolio securities were selected, in the interest of directors, officers, investment advisers, and other af-

filiated persons thereof, and in the interest of underwriters, brokers and dealers, rather than in the interest of all classes of plaintiff's securityholders;

(b) the plaintiff was caused to publish, circulate and file with the Securities and Exchange Commission [fol. 7] required registration statements, amendments thereto, reports and prospectuses, which documents contained untrue statements of material facts or omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading;

(c) the plaintiff was caused to deviate from a fundamental policy recited in its registration statement pursuant to Section 8 (b) (2) of the Act, without being authorized to do so by the vote of a majority of its outstanding voting securities; and

(d) defendants Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of a co-partnership doing business under the name of Model, Roland & Stone, and Stephen M. Jaquith, individually, served or acted as investment advisers of the plaintiff, without a written contract approved by the vote of a majority of the outstanding voting securities of plaintiff.

22. By reason of the aforesaid violations of the Investment Company Act of 1940 by the defendants it has been necessary for plaintiff to stop the sale of its shares until such time as it can strictly comply with said Act, and the rules thereunder; that its good name and good will, and competitive position have been thereby injured.

23. By reason of all of the foregoing acts plaintiff is entitled to recover the damages it has sustained thereby and the profits thereby made by the defendants; that plaintiff is unable to state, without a full accounting, the amount of said damages and profits, and that an accounting should be had herein.

Wherefore, plaintiff prays judgment against all of the defendants, adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment rendered thereon in favor of plaintiff for its damages, including the unlawful profits received by defendants, and for such other relief as to the Court may seem meet and proper.

[fol. 8] Count II.

Comes now the plaintiff and as and for its second claim for relief against defendants, and each of them, states as follows:

1. This Court has jurisdiction of this claim for relief by reason of the fact that it, and the grounds therefor, arise out of the same acts, occurrences and transactions as those set forth and complained of in Count I of this Amended Complaint wherein this Court has jurisdiction as set forth in Paragraph 1 of said Count I.

2. The allegations of Paragraphs 2 through 20 of Count I are here incorporated by reference as though set forth in haec verba in this Count II of this Amended Complaint.

3. By reason of the acts and things hereinabove set forth, plaintiff was caused to file similar registration statements, prospectuses and reports under the Securities Act of 1933, as amended, and may be liable in actions under such Act to persons, if any, injured and thereby damaged. In addition, the Securities and Exchange Commission, by reason thereof, instituted stop order proceedings In the Matter of Managed Funds, Incorporated, File No. 2-11061 under the Securities Act of 1933, Section 8 (d), in which proceedings, after lengthy hearings, the Commission, on July 30, 1959, issued its findings and opinion and stop order whereby plaintiff's good name, good will, and competitive position have been greatly injured and damaged, and plaintiff has been caused to expend large sums of money for counsel fees and other expenses in connection with such stop order proceedings, and any matters incident thereto.

4. By reason of all of the foregoing acts plaintiff is entitled to recover damages it has sustained thereby, and to the profits thereby made by the defendants; that plaintiff is unable to state without a full accounting the amount of said damage and profits, and that an accounting should be had herein.

Wherefore, plaintiff prays judgment against all of the defendants adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment [fol. 9] rendered thereon in favor of plaintiff for its damages, including the unlawful profits received by defendants, and for such other relief as to the Court may seem meet and proper.

Count III.

Comes now the plaintiff and as and for its third claim for relief against defendants, and each of them, states as follows:

1. This Court has jurisdiction of this claim for relief by reason of the fact that it, and the grounds therefor, arise out of the same acts, occurrences and transactions as those set forth in Count I of this Amended Complaint where in this Court has jurisdiction as set forth in Paragraph 1 of said Count I.

2. The allegations of Paragraphs 2 through 20 of Count I are here incorporated by reference as though set forth in haec verba in this Count III of this Amended Complaint.

3. Defendants Hilton H. Slayton and Hovey E. Slayton, as directors and President and Vice-President, respectively, of plaintiff, were acting in a fiduciary capacity with respect to plaintiff, and owed to plaintiff the duty of undivided loyalty in the operation of plaintiff and in the management of its affairs; defendants Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of a co-partnership doing business under the name of Model, Roland & Stone, and Stephen M. Jaquith, individually, were acting as investment advisers of the

plaintiff, and hence in a fiduciary capacity with respect to the plaintiff, and owed to plaintiff the duties and obligations of fiduciaries; and each of the other defendants had actual knowledge of the relationship of defendants Hilton H. Slayton and Hovey E. Slayton to plaintiff, and actual or constructive knowledge of the relationship of said members of the co-partnership of Model, Roland & Stone, and of Stephen M. Jaquith, to plaintiff.

4. By reason of the unlawful and wrongful acts hereinabove set forth, defendants Hilton H. Slayton and Hovey E. Slayton wholly disregarded and breached their duties [fol. 10] and obligations as officers, directors, trustees and fiduciaries of the plaintiff, and, at the expense of and to the damage of plaintiff, mismanaged the affairs of plaintiff, caused plaintiff to make payment of fees and commissions to the defendants Slayton Associates, Inc., Mutual Fund Distributors, Inc., Slayton & Company, Inc., the members of the co-partnership of Model, Roland & Stone, Stephen M. Jaquith, James S. Stubbs and Harold W. Smith, committing waste to the property and assets of the plaintiff, all to the profit of said defendants and of the other defendants except the said outside directors.

5. By reason of the unlawful and wrongful acts hereinabove set forth, the defendants Leo Model, Rolf H. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of the co-partnership doing business under the name of Model, Roland & Stone, and the defendant Stephen M. Jaquith, individually, wholly disregarded and breached their duties as fiduciaries of the plaintiff, and participated in, aided, abetted, condoned and acquiesced in said mismanagement of the affairs of the plaintiff at the expense of and to the damage of plaintiff, and to their own great profit.

6. All of the defendants had actual knowledge of the fact of the relationship of defendants Hilton H. Slayton and Hovey E. Slayton to plaintiff; all of the defendants had actual or constructive knowledge of the relationship of the said defendants Leo Model, Rolf R. Roland, Frits

Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of the co-partnership doing business under the name of Model, Roland & Stone, and defendant Stephen M. Jaquith; and hence all defendants are chargeable with and liable for the said acts.

7. By reason of all of the foregoing acts plaintiff is entitled to recover the damages it has sustained and to the profits thereby wrongfully made by certain of the defendants; plaintiff is unable to state, without a full accounting, the amount of said damages and profits, and an accounting should be had herein.

[fol. 11] Wherefore, plaintiff prays judgment against all the defendants, adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment rendered thereon in favor of plaintiff for its damages, including the wrongful profits received by defendants, and for such other relief as to the Court may seem meet and proper.

Count IV.

Comes now the plaintiff and as and for its fourth claim for relief against the defendants, and each of them, states as follows:

1. The allegations of Paragraphs 2 through 20 of Count I and Paragraphs 3 through 6 of Count III of this Amended Complaint are here incorporated by reference as though set out at length here in this Count IV of this Amended Complaint.

2. All of said defendants' acts were unlawful and wrongfully committed as a part of, and pursuant to, an unlawful agreement and conspiracy between all of said defendants, except said outside directors, for the purpose of unlawfully making use of the business and funds of plaintiff, to the plaintiff's damage and to the great profit of the said defendants; and said outside directors, as hereinabove set forth, had either actual or constructive knowledge of, did nothing to prevent the consummation of, and are hence

chargeable with liability for, such unlawful agreement and conspiracy.

3. By reason of the foregoing acts and conspiracy plaintiff is entitled to recover the damages it has sustained and to the profits thereby made by the defendants; plaintiff is unable to state, without a full accounting, the amount of such damages and profits; and an accounting should be had herein.

Wherefore, plaintiff prays judgment against all of the defendants, adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment rendered thereon in favor of plaintiff for its damages, including the wrongful profits received by defendants, [fol. 12] and for such other relief as to the Court may seem meet and proper.

R. H. McRoberts, Gaylord C. Burke, Marion S. Francis, 1630 Boatmen's Bank Building, St. Louis 2, Missouri.

Bryan, Cave, McPheeters & McRoberts, Of Counsel.

[fol. 12]

IN UNITED STATES DISTRICT COURT

DISTRICT OF DELAWARE

Civil Action No. 2100

EMANUEL JOSEPHSON, Plaintiff,

—against—

HILTON H. SLAYTON, HOVEY E. SLAYTON, JR., STEPHEN M. JAQUITH, HOWARD W. SMITH, JAMES S. STUBBS, a Partnership of "JOHN" MODEL, "JAMES" ROLAND and "JACK" STONE, First Names Being Fictitious and Unknown, Doing Business Under the Trade Name of MODEL, ROLAND AND STONE, EARL R. RICE, LLOYD E. BOAS, JEFFERSON J. REBSTOCK, JAMES J. MULLEN, JR., JOHN BROUK, ROBERT A. HICKS, W. MUNRO ROBERTS, JR., SLAYTON ASSOCIATES, INC., SLAYTON & COMPANY, INC., MUTUAL FUND DISTRIBUTORS, INC., AND MANAGED FUNDS, INCORPORATED, Defendants.

COMPLAINT IN No. 59 CIVIL 279 (3)—
Filed May 12, 1959

(Transferred from U. S. District Court,
District of Delaware.)

Plaintiff, above named, by his attorney, as and for his bill of complaint shows and alleges, upon information [fol. 13] and belief, except as to paragraphs marked "First" and "Second", which are alleged upon knowledge:

First: That plaintiff has continuously been and now is the owner of shares of stock of Managed Funds Incorporated (referred to as "MF") and more particularly was a shareholder of MF at the times of the transactions of which he complains and which are now continuing.

Second: That this is a derivative action brought by the plaintiff in the right of and for the benefit of MF.

Third: That the jurisdiction of this action arises by virtue of the defendants' violations of the Investment Company Act of 1940, and its rules (U. S. Code, Title 15, Section 80a, et seq.) and the Investment Advisers Act of 1940 and its rules (U. S. Code, Title 15, Section 80b, et seq.).

Fourth: That MF is a Delaware corporation, principally engaged and registered as a publicly held open-end investment company under the Investment Company Act of 1940.

Fifth: That Slayton Associates, Inc. (referred to as "SA"), is a Delaware corporation principally engaged and registered as an investment adviser under the Investment Advisers Act of 1940.

Sixth: That all times hereinafter mentioned, Hovey E. Slayton, Jr., and Hilton H. Slayton were the sole stockholders, principal officers and directors of SA.

Seventh: That Howard W. Smith is the brother-in-law of Hovey E. Slayton and has served as his alter ego.

Eighth: That Edward W. Smith, together with his wife Virginia Slayton Smith, are voting trustees with Hovey E.

Slayton, Jr., in the voting of the largest block and controlling shares of Slayton & Company, Inc., a registered broker-dealer principally engaged in the distribution of MF shares to the general public.

Ninth: That James S. Stubbs is a former business associate of Hilton H. Slayton and a former director of MF.

[fol. 14] Tenth: That at all times hereinafter mentioned, there existed a close business relationship between Smith, Stubbs and the Slaytons.

Eleventh: That at all times hereinafter mentioned, the individuals, Slayton, Slayton, Jr., Rice, Boas, Rebstock, Mullen, Jr., Brouk, Hicks and Roberts, Jr., were the directors of MF.

Twelfth: That at all times hereinafter mentioned, Hilton H. Slayton and Hovey E. Slayton, Jr., were respectively the president and executive vice-president of MF and constituted its principal operating heads and persons in working control of MF.

Thirteenth: That at all times hereinafter mentioned, the partnership and trade name of Model, Roland and Stone, consisting of partners "John" Model, "James" Roland and "Jack" Stone, the true first names being unknown and fictitious, engaged in the sale and purchase of securities as members of the New York Stock Exchange.

Fourteenth: That at all times hereinafter mentioned, Stephen M. Jaquith was principally engaged as an investment adviser and associated with Model, Roland & Stone.

Fifteenth: That in accordance with the applicable regulations of the Investment Company Act, MF offered its shares for sale upon the expressed policy that it will be the principal and primary purpose of MF to provide for "capital growth" on all series and to the extent consistent with the foregoing policy MF will seek reasonable income on its investments, which net investment income and any realized profits from the sale of portfolio securities would be distributed quarterly.

Sixteenth: That commencing with August 15, 1952 and continuing to the date of the commencement of this action,

SA has been employed by MF as investment adviser pursuant to successive written contracts, which among other provisions, represented that SA was able and had the know-how to render the specific and general services of investment adviser.

[fol. 15] Seventeenth: That by reason of the agreement of August 15, 1952 now in effect between MF and SA, SA was obligated to and undertook to furnish advisory, research and statistical services required by MF's investment policies.

Eighteenth: That since December 1, 1953 and continuing up to the present, MF has paid to SA in excess of $1,000,000.00 for the investment services allegedly rendered under the terms of the contract.

Nineteenth: That the agreement of August 15, 1952 between MF and SA was not assignable and did not authorize abdication or delegation of the advisory services to or by any substitute representative and in any event would be illegal.

Twentieth: That commencing with December 1, 1953 and continuing to date, Stephen J. Jaquith became and assumed the activities of an investment adviser for MF by reason of an agreement made between Jaquith and SA which in essence required Jaquith, then an employee of Model, Roland and Stone, under the general direction and approval of SA to use his best judgment in the selection, purchase and sale of securities under the general policy of SA as it would be determined from time to time and that SA in payment for the services to be rendered, agreed to direct brokerage commission business to Jaquith or to such persons or firms as he might designate for a 5 year period in a total minimum amount of $250,000 in commissions, payable at $50,000 per annum minimum and for a second five year period in a total minimum of $175,000 at $35,000 per year minimum.

Twenty-First: That at all the times hereinafter mentioned and commencing with December 1, 1953, Model, Roland and Stone, Jaquith, Smith and Stubbs shared and participated in the division of commissions exceeding a

total of $1,600,000 that SA had directed MF to give to Model, Roland & Stone, pursuant to the designation and direction of Jaquith.

Twenty-Second: That since December 1, 1953, and continuing to the present, while Jaquith served as investment [fol. 16] adviser to MF, the published principal and primary policy of MF of "capital growth" was illegally changed so as to maintain a predetermined amount of distributions on MF's shares from year to year and when the investment income was not adequate to provide for such distributions, to realize gains on sales of portfolio securities in order to maintain the distributions at the desired rate, without the approval of the stockholders of MF and illegal under the applicable law.

Twenty-Third: That since December 1, 1953 and continuing to the present, the acts of the defendants have violated the primary and principal policy of "capital growth" on all series of MF's shares.

Twenty-Fourth: That in 1958 and as an instance, the ratio of turnover of the portfolio securities has been 98% of the fund as compared with a 20% average in the trade.

Twenty-Fifth: That the illegal agreement between Jaquith and SA was never approved by the stockholders of MF, within the provisions of the Investment Company Act.

Twenty-Sixth: That despite the performance of the investment advisory service rendered by Jaquith, SA continued to receive and accept compensation in excess of $1,000,000 from MF for services that it did not perform.

Twenty-Seventh: That since December 1, 1953, and continuing to date, MF utilized realized capital gains under equalization credits and such equalization accounts were reflected under the caption Net Investment Income in the statement of net assets for each of the published financial annual and semi-annual reports ending November 30, 1954-1958, thereby rendering such reports false and misleading.

Twenty-Eighth: That at all times hereinafter mentioned, Slayton & Company, Inc. (referred to as "Slayco") and

Mutual Fund Distributors, Inc. (referred to as "Mutual") are Missouri corporations, principally engaged as broker-dealer underwriters for the sale and distribution of MF shares.

[fol. 17] Twenty-Ninth: That at all the times hereinafter mentioned, the principal and controlling stockholders, officers and directors of Slayco and Mutual were Hilton H. Slayton and Hovey E. Slayton, Jr. (also operating through a voting trust agreement with Virginia and Howard W. Smith (sister and brother-in-law of Slayton)).

Thirtieth: That since 1952 and continuing to date, MF at the instance and direction of Hilton H. Slayton and Hovey E. Slayton, Jr., gave all of the MF underwritings for the sale of its shares to Slayco and Mutual at the fixed and unaltered rate of commission of 9.89% of the net asset value of the shares without seriously and reasonably seeking out competitive underwriters at lesser rates and failing to properly adjust downwards the existing selling charges.

Thirty-First: That since 1952 and continuing to date Slayco and Mutual have rendered nominal services by reason of their channelling all the underwriting of MF shares through others, which has resulted in tremendous net commissions of about 2½% of the aggregate, as a gift to Slayco and Mutual.

Thirty-Second: That since 1952 and continuing to date, Slayco and Mutual have benefited to the extent of at least $500,000 in excessive and unnecessary commissions.

Thirty-Third: That since 1954 and continuing to date, Hilton H. Slayton and Hovey E. Slayton, Jr., have received compensation aggregating in excess of $100,000 for services rendered as officers of MF, when in fact, no services were rendered.

Thirty-Fourth: That the defendants in the instances and at the times mentioned committed, aided, abetted, acquiesced and condoned, directly and indirectly, the violations by MF of the provisions of the Investment Company Act of 1940 and the Investment Advisers Act and the rules applicable thereto, by:

(a) omitting material facts required to be stated.

(b) filing reports containing untrue statements of material facts.

[fol. 18] (c) omitting to state facts necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading, by doing

as follows:

(1) Omitted to state in the reports of MF that since December 1, 1953, Jaquith had become an investment adviser of MF by reason of the contract of December 1, 1953, between SA and Jaquith; the terms of compensation to Jaquith through Model, Roland & Stone.

(2) Omitted to state in the reports of MF that SA was obligated to furnish advisory services to MF under its contract of August 15, 1952, and that SA's agreement with Jaquith constituted an abdication and delegation to Jaquith of SA's duties.

(3) Omitted to state that Jaquith was employed by Model, Roland & Stone, stockbrokers; that SA had not performed the services required of it for which it had received payment; that SA directed commissions to Jaquith through Model, Roland & Stone in excess of $1,600,000 at the instance of Jaquith to be shared between Jaquith, Smith (Slayton's brother-in-law) Model, Roland & Stone and Stubbs (an associate of Slayton) in exchange for the investment advisory services; that such agreements and participation was in violation of law and was therefore illegal.

(4) Omitted to state that the agreement of December 1, 1953, between SA and Jaquith was illegal; that payments were made to persons Smith, Stubbs and Jaquith because of illegal agreements; that the payments made to SA were illegal and without consideration.

(5) Omitted to state that MF changed its basic policy of "capital growth"; that the MF financial

statements for realized gains, were improperly included in equalization credits and that such equalization accounts were reflected under the caption Net Investment Income in the statement of net assets; that the financial statements of MF without any explanatory [fol. 19] note were misleading and false in contravention to law.

(6) Omitted to state that MF was granting a preference with excessive and wasteful charges for commissions and compensation to SA, Slayco and Mutual because of the relationship and interests of the respective controlling persons.

(7) Omitted to state that the salaries paid to the Slaytons were gratuities, wasteful and unnecessary under the circumstances then prevailing.

(8) Omitted to state that the greatest single beneficiary of MF is Hilton H. Slayton and Hovey E. Slayton, Jr., by reason of payments made to them through their alter egos.

Thirty-Fifth: That the wrongful acts herein described, have been and continue to be committed by the defendants against MF in breach of legal and fiduciary obligations that are inherent by reason of the relationship of the parties.

Thirty-Sixth: That plaintiff has made no demand upon MF or its directors to institute this suit, inasmuch as such a demand would be futile and unavailing for the reason that the directors of MF have approved, acquiesced in, ratified, committed and are committing the very wrongful, wilful and illegal acts complained of herein, and the said directors are serving with the approval of, domination and control of the Slaytons and are beholden and completely subservient to their wishes, direction and control, with the result that a demand upon said defendants to bring an action on behalf of MF and against the remaining defendants would be tantamount to requesting them to prosecute a suit against themselves and such demand would in any event be futile and unavailing.

Thirty-Sixth: (sic) That plaintiff has not consented to, ratified nor acquiesced in the activities and misconduct of the defendants, as aforesaid, which activities were conceived and perpetrated without the knowledge of the plaintiff, but were in fact, carefully concealed from plaintiff and the other stockholders and the Securities and Exchange [fol. 20] Commission; that the plaintiff did not become aware of the illegal acts herein until April, 1959.

Thirty-Seventh: That plaintiff has no adequate remedy at law.

Thirty-Eighth: That the defendants be enjoined from continuing the illegal acts and be held to account for the losses, damages and illegal payments for the benefit of MF.

Wherefore, plaintiff demands judgment against all the defendants for

(a) Accounting (except MF).

(b) Injunction.

(c) Damages (excepf MF).

(d) Other relief as this Court may deem necessary, and reasonable counsel and accounting fees, together with the disbursements and costs of this action.

Cohen and Morris, By Irving Morris, Attorney for Plaintiff, 300 North American Bldg., Wilmington, Delaware.

Of Counsel: Louis H. O. Fischman, Esquire, 276 Fifth Avenue, New York City, New York.

Duly sworn to by Emanuel Josephson (jurat omitted in printing).

[fol. 21]

In United States District Court for the

Eastern District of Missouri

Eastern Division

Civil Action No. 59 C 162 (3)

Managed Funds, Incorporated, a Corporation, Plaintiff,

vs.

Slayton Associates, Inc., a Corporation et al., Defendants.

Joint Motion of Defendants J. John Brouk et al., to Dismiss in No. 59 Civil 162 (3)—Filed January 4, 1960

Defendants, J. John Brouk, W. Munro Roberts, Jr. and James J. Mullen, Jr., jointly move the Court to dismiss Counts I, II, III, IV of plaintiff's amended complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction respecting Counts I to III, inclusive, of the claim averred in said Counts upon alleged violations of the Investment Company Act of 1940, Title 15 U. S. C. A., Section 80a et seq., and that said Act does not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in Counts I, II, and III of plaintiff's amended complaint either expressly or by implication; that Count IV of plaintiff's amended complaint fails to aver any basis whatsoever for jurisdiction of this Court respecting such Count, and that each of Counts I, II, III and IV fail to aver a cause of action [fol. 22] within the jurisdiction of this Court against these defendants arising under the Constitution laws and treaties of the United States, and fail to present a Federal question respecting which this Court has jurisdiction.

Defendant requests oral argument on this motion.

Forrest M. Hemker, Attorney for Defendants, J. John Brouk, W. Munro Roberts, Jr., and James J. Mullen, Jr.

Greensfelder, Hemker & Wiese, Suite 1212, 705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

In United States District Court

Motion of Defendant Jefferson J. Rebstock to Dismiss in No. 59 Civil 162 (3)—Filed December 4, 1959

Defendant, Jefferson J. Rebstock, a citizen and resident of the State of Louisiana, appearing specially and solely for the purpose of this motion and for no other purpose, moves the Court as follows:

1. To dismiss Counts I, II and III of plaintiff's amended complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction respecting Counts I to III, inclusive, of the claims averred in said Counts upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 80a et seq., and that said Act does not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in Counts I, II and III of plaintiff's amended complaint either expressly or by implication.

2. To dismiss Counts I, II, III and IV of plaintiff's amended complaint for lack of jurisdiction of the person of this defendant and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Louisiana as appears from affidavit attached hereto and is not subject to service [fol. 23] of process outside of the State of Missouri under any of the claims averred in Counts I, II, III and IV of plaintiff's amended complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Missouri respecting said claims and under Federal Rule 4(f) process may be served only within the territorial limits of the State of Missouri, and for the further reason that Count IV of plaintiff's amended complaint fails to aver any grounds of jurisdiction of this Court.

3. Defendant requests oral argument on this motion.

Forrest M. Hemker, Attorney for Defendant, Jefferson J. Rebstock.

Greensfelder, Hemker & Wiese.

In United States District Court

Motion of Defendant Earl R. Rice to Dismiss in No. 59 Civil 162 (3)—Filed December 28, 1959

Defendant, Earl R. Rice, a citizen and resident of the State of Florida, appearing specially and solely for the purpose of this motion and for no other purpose, moves the Court as follows:

1. To dismiss Counts I, II and III of plaintiff's amended complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction respecting Counts I to III, inclusive, of the claim averred in said Counts upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 8a et seq., and that said Act does not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in Counts I, II and III of plaintiff's amended complaint either expressly or by implication.

2. To dismiss Counts I, II, III and IV of plaintiff's amended complaint for lack of jurisdiction of the person [fol. 24] of this defendant and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Florida as appears from affidavit attached hereto and is not subject to service of process outside of the State of Missouri under any of the claims averred in Counts I, II, III and IV of plaintiff's amended complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Missouri respecting said claims and under Federal Rule 4(f) process may be served only within the territorial limits of the State of Missouri, and for the further reason that Count IV of plaintiff's amended complaint fails to aver any grounds of jurisdiction of this Court.

3. Defendant requests oral argument on this motion.

Forrest M. Hemker, Attorney for Defendant, Earl R. Rice.

Greensfelder, Hemker & Wiese.

In United States District Court for the
Eastern District of Missouri
Eastern Division
No. 59-C-279 (3)

Emanuel Josephson, Plaintiff,

vs.

Hilton H. Slayton, et al., Defendants.

Supplementary Motion of Defendant Jefferson J. Rebstock to Dismiss Complaint in No. 59 Civil 279 (3)—Filed April 19, 1960

Defendant, Jefferson J. Rebstock, a citizen and resident of the State of Louisiana, appearing specially and solely for the purpose of this motion and for no other purpose, [fol. 25] files this motion as a supplementary motion to this defendant's motion to dismiss heretofore filed, and moves the Court as follows:

1. To dismiss plaintiff Emanuel Josephson's complaint for the reasons set out in this defendant's motion heretofore filed herein.

2. To dismiss plaintiff Emanuel Josephson's complaint for lack of jurisdiction of the person of this defendant, and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Louisiana, and is not subject to service of process outside of the State of Delaware, or after transfer to this Court outside of the State of Missouri under any of the claims averred in plaintiff's complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Delaware or Missouri respecting said claims, and under Federal Rule 4 (f) process may be served only within the territorial limits of the State of Missouri.

3. To dismiss Emanuel Josephson's complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction of the claim averred upon alleged violations of the Investment Company Act of 1940 Title 15 U. S. C. A. Section 80a et seq., and the rules promulgated by the Securities and Exchange Commission thereunder, and that said Act and rules do not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in his complaint either expressly or by implication, and for the further reason that the complaint fails to aver any basis whatsoever for or within jurisdiction of this Court arising under the Constitution, laws and treaties of the United States, and fails to present a Federal question respecting which this Court has jurisdiction.

Forrest M. Hemker, Attorney for Defendant, Jefferson J. Rebstock.

Greensfelder, Hemker & Wiese.

[fol. 26]

IN UNITED STATES DISTRICT COURT

SUPPLEMENTARY MOTION OF DEFENDANT EARL R. RICE TO DISMISS COMPLAINT IN NO. 59 CIVIL 279 (3)—Filed April 19, 1960

Defendant, Earl R. Rice, a citizen and resident of the State of Florida, appearing specially and solely for the purpose of this motion and for no other purpose, files this motion as a supplementary motion to this defendant's motion to dismiss heretofore filed, and moves the Court as follows:

1. To dismiss plaintiff Emanuel Josephson's complaint for the reasons set out in this defendant's motion heretofore filed herein.

2. To dismiss plaintiff Emanuel Josephson's complaint for lack of jurisdiction of the person of this defendant, and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Florida, and is not subject to service of process

outside of the State of Delaware, or after transfer to this Court outside of the State of Missouri under any of the claims averred in plaintiff's complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Delaware or Missouri respecting said claims, and under Federal Rule 4 (f) process may be served only within the territorial limits of the State of Missouri.

3. To dismiss Emanuel Josephson's complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction of the claim averred upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 80a et seq., and the rules promulgated by the Securities and Exchange Commission thereunder, and that said Act and rules do not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in his complaint either expressly or by implication, and for the further reason that the complaint fails to aver any basis whatsoever for or within jurisdiction of this Court arising under the Constitution, laws and treaties [fol. 27] of the United States, and fails to present a Federal question respecting which this Court has jurisdiction.

Forrest M. Hemker, Attorney for Defendant, Earl R. Rice.

Greensfelder, Hemker & Wiese.

IN UNITED STATES DISTRICT COURT

SUPPLEMENTARY MOTION OF DEFENDANTS W. MUNRO ROBERTS, JR. ET AL., TO DISMISS COMPLAINT IN NO. 59 CIVIL 279 (3)—Filed April 19, 1960

Defendants, W. Munro Roberts, Jr., James J. Mullen, Jr., and J. John Brouk, are citizens and residents of the State of Missouri, appearing specially and solely for the purpose of this motion and for no other purpose, file this motion as a supplementary motion to these defendants' motion to dismiss heretofore filed, and move the Court as follows:

1. To dismiss plaintiff Emanuel Josephson's complaint for the reasons set out in the motion of these defendants heretofore filed herein.

2. To dismiss plaintiff Emanuel Josephson's complaint for lack of jurisdiction of the person of these defendants, and to quash the return of service of summons on these defendants on the ground that they are citizens and residents of the State of Missouri, and are not subject to service of process outside the State of Delaware under any of the claims averred in plaintiff's complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Delaware and the transfer of this cause to this Court from the District Court of Delaware does not validate the process issued by the District Court of Delaware served outside of the State of Delaware.

[fol. 28] 3. To dismiss Emanuel Josephson's complaint for lack of jurisdiction of the subject matter in that plaintiff bases jurisdiction of the claim averred upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 80a et seq., and the rules promulgated by the Securities and Exchange Commission thereunder, and that said Act and rules do not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in his complaint either expressly or by implication, and for the further reason that the complaint fails to aver any basis whatsoever for or within the jurisdiction of this Court arising under the Constitution, laws and treaties of the United States, and fails to present a Federal question respecting which this Court has jurisdiction.

Forrest M. Hemker, Attorney for Defendants, W. Munro Roberts, Jr., James J. Mullen, Jr., and J. John Brouk.

Greensfelder, Hemker & Wiese.

IN UNITED STATES DISTRICT COURT

STATEMENT OF FILING OF MOTIONS SIMILAR TO MOTIONS OF RICE, REBSTOCK, BROUK, ROBERTS AND MULLEN

As reflected in the following Order dated July 1, 1960 of the United States District Court, Honorable Randolph H. Weber, Judge, motions similar to the motions of appellants, Rice, Rebstock, Brouk, Roberts and Mullen, were filed by other defendants-appellants, all of which motions were overruled in said Order.

[fol. 29]

IN UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI

EASTERN DIVISION

No. 59 C 162 (3)

MANAGED FUNDS, INC., Plaintiff,

vs.

SLAYTON ASSOCIATES, a Corporation, et al., Defendants.

No. 59 C 279 (3)

EMANUEL JOSEPHSON, Plaintiff,

PROTECTIVE CASUALTY INS. CO., Intervenor-Plaintiff,

vs.

HILTON H. SLAYTON, ET AL., Defendants.

ORDER OF DISTRICT COURT OVERRULING MOTIONS TO DISMISS—July 1, 1960

Various motions are pending in the above causes, which have been consolidated, memorandums and briefs have been filed therein, and in some instances hearings held thereon, and the Court now being fully advised does Order as follows:

1. In Cause No. 59 C 162:

A. Separate Motion of defendant Robert A. Hicks to Dismiss is overruled.

B. Motion of defendant Charles E. Brown to Dismiss is overruled.

C. Joint Motion of defendants Brouk, Roberts and Mullen to Dismiss is overruled.

D. Motion to Dismiss of defendant Earl R. Rice is overruled.

E. Motion to Dismiss of defendant Edwin J. Cunningham is overruled.

[fol. 30] F. Motion of defendant Jacob Baker to Dismiss is overruled.

G. Motion of defendant Jefferson J. Rebstock to Dismiss is overruled.

H. Motion of defendant George H. Shields, III, to Dismiss is overruled.

2. In Cause No. 59 C 279:

A. Defendant Managed Funds' Motion to Dismiss is overruled.

B. Defendants Rice, Boas, Rebstock, Mullen, Brouk and Roberts' Joint Motion to Dismiss, and the Supplemental Motion of defendants Roberts, Mullen and Brouk to Dismiss and the separate Supplemental Motions to Dismiss by defendants Rebstock and Rice are each and all separately overruled.

C. Joint Motion of defendants Slaytons, and Slayton Associates, Inc., to Dismiss, for Summary Judgment, to Dismiss for Failure to State a Claim, and Make More Definite and Certain are each and all hereby overruled.

D. Motion to Dismiss by defendant Hicks is overruled.

E. Motions of defendants, Slaytons, Slayton Associates, Slayton and Company, Inc., and Mutual Fund Distributors, Inc., to Dismiss or Enter Judgment of Dismissal, to

Strike, to Make More Definite and Certain and to State Separate Claims are each and all overruled.

F. Motion of defendants Boas, Rebstock, Rice, Mullen, Brouk and Roberts to Strike affidavit of plaintiff's counsel is overruled.

G. Motions for Protective Order and to Dismiss of defendants Model, Roland and Stone, Jaquith, Smith and Stubbs are overruled.

H. Motion of defendants Roberts, Mullen and Brouk to Dismiss Supplemental Complaint of Intervenor and Quash Service and Separate Motions of Defendants Rebstock and [fol. 31] Rice to Dismiss Supplemental Complaint of Intervenor and Quash Service are each and all overruled.

3. The Motions to Dismiss aforesaid were based upon the proposition that the Court does not have jurisdiction in that it is contended that the Investment Company Act does not provide for suits by individuals or corporations and therefore there is no federal question involved and the long-arm provisions for service do not apply.

Therefore, the Court's Order overruling the Motions to Dismiss, being otherwise non-appealable, and the Court being of the opinion that its Order on the Motions to Dismiss for lack of jurisdictions of the subject matter of the action and of the person of certain defendants, involves a controlling question of law upon which there is substantial ground for difference of opinion and that an immediate appeal from the Court's Order may materially advance the ultimate termination of the litigation, it is

Further Ordered that all parties affected by the Court's Order herein may make application for appeal under the provisions of § 1292 (b), Title 28, U. S. C., and if so, and if appeal is permitted, the proceedings herein are stayed until further order.

Done this 1st day of July, 1960.

Randolph H Weber, United States District Judge.

In United States District Court

Notice of Appeal of J. John Brouk et al. in Nos. 59 Civil 162 (3) and 279 (3)—Filed August 9, 1960

Notice is hereby given that J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, defendants herein, hereby appeal to the United States Court of Appeals for the Eighth Circuit from sections 1 and 2 of the Order entered in these consolidated causes on July 1, 1960 by Honorable Randolph [fol. 32] H. Weber, United States District Judge for the Eastern District of Missouri, a copy of which Order is attached hereto and identified as "Exhibit A."

Greensfelder, Hemker & Wiese, Attorneys for J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, By Mark R. Gale, Suite 1212—705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

In order to avoid duplication, "Exhibit A" referred to in the Notice of Appeal, being the Order of Honorable Randolph Weber, United States District Judge, overruling the motions of the appellants, and other motions, in these consolidated causes is not attached, since such order is already included in the record on preceding pages.

In United States District Court

Designation of Record on Appeal of J. John Brouk et al., in Nos. 59 Civil 162 (3) and 279 (3)—Filed August 23, 1960

Pursuant to Rule 75 (a) of the Federal Rules of Civil Procedure and Rule 8 (b) of the United States Court of Appeals of the Eighth Circuit, the above named appellants hereby designate the following portion of the above to be contained in the record on appeal in the above entitled consolidated actions to the United States Court of Appeals for the Eighth Circuit:

1. The amended complaint of Managed Funds, Inc., Plaintiff, vs. Slayton Associates et al., Defendants, in Cause No. 59 C 162 (3).

2. Complaint of Emanuel Josephson, Plaintiff, vs. Hilton H. Slayton et al., in Cause No. 59 C 279 (3).

[fol. 33] 3. Docket entry of Jan. 29, 1960 showing adoption by intervenor, Protective Casualty Ins. Co., of complaint referred to in paragraph 2 above as its complaint.

4. Joint motion of appellants, J. John Brouk, W. Munro Roberts, Jr. and James J. Mullen, Jr., to dismiss the amended complaint of Managed Funds, Incorporated for lack of jurisdiction of the subject matter in Cause No. 59 C 162 (3), filed January 4, 1960.

5. Motion of appellant, Jefferson J. Rebstock, to dismiss the amended complaint of Managed Funds, Inc. for lack of jurisdiction of the subject matter and of the person, in Cause No. 59 C 162 (3), filed December 7, 1959.

6. Motion of appellant, Earl R. Rice, to dismiss the amended complaint of Managed Funds, Inc. for lack of jurisdiction of the subject matter and of the person in Cause No. 59 C 162 (3), filed December 28, 1959.

7. Supplementary motion of appellants, Jefferson J. Rebstock and Earl R. Rice, to dismiss the complaint of Emanuel Josephson for lack of jurisdiction of the subject matter and person, and supplementary motion of appellants, J. John Brouk, James J. Mullen, Jr. and W. Munro Roberts, Jr., to dismiss said complaint on the lack of jurisdiction of the subject matter and of their person in Cause No. 59 C 279 (3), filed April 19, 1960.

8. Docket entry in Cause No. 59 C 279 (3) reflecting filing of similar motions against intervenor, Protective Casualty Insurance Company's complaint by adoption, namely the Josephson complaint.

9. Docket entries in Cause No. 59 C 162 (3) reflecting the filing of motions to dismiss the complaint of Managed Funds, Inc. by appellants Edwin J. Cunningham the 28th day of December, 1959, Jacob Baker the 8th day of December, 1959, George H. Shields III the 3rd day of December,

1959, Charles E. Brown the 8th day of January, 1960 and Robert A. Hicks the 11th day of January, 1960.

10. The Order of Honorable Randolph Weber, United States District Judge, filed July 1, 1960, overruling all of the aforesaid motions, and other motions, in these consolidated causes.

[fol. 34] 11. Notice of Appeal filed August 9, 1960.

12. Statement of points upon which appellants intend to rely on appeal (a concise statement of the points upon which appellants intend to rely on appeal is appended to this designation).

13. Proof of service of this designation and the statement of points upon which appellants intend to rely.

(Appellants reserve the right to designate further or other portions of the record and proceedings to be contained in the record on appeal, if such procedure be deemed necessary by reason of the filing by appellees of any counter designation on any objections to this designation.)

Greensfelder, Hemker & Wiese, by Forrest M. Hemker, Attorneys for Appellants, J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, 705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

IN UNITED STATES DISTRICT COURT

STATEMENT OF POINTS UPON WHICH APPELLANTS J. JOHN BROUK ET AL., INTEND TO RELY ON APPEAL IN NOS. 59 CIVIL 162 (3) AND 279 (3)—Filed August 23, 1960

The above named appellants state that the points upon which they intend to rely on this appeal are as follows:

1. The District Court erred in overruling appellants' motions filed in these consolidated causes to dismiss the complaint of Managed Funds, Inc., Cause No. 59 C 162 (3)

and Emanuel Josephson, No. 59 C 279 (3), and as adopted by intervenor, Protective Casualty Insurance Company as and for its complaint, on the ground of lack of jurisdiction of the subject matter and of the person of appellants for the following reasons:

[fol. 35] (a) Federal jurisdiction is claimed and averred to exist solely by virtue of alleged violations of the Investment Company and Advisers Company Act of 1940, 15 U. S. C. A. 80a and 80b, which act, however, does not create any federally protected rights, either expressly or by implication, giving rise to a cause of action of which the Federal Courts have jurisdiction, derivative or otherwise, by a registered investment company against its officers and directors, and alleged outsiders acting in concert with them alleged to have violated the act.

(b) The complaints therefore fail to state a case arising under the laws of the United States, and the District Court of the United States was without jurisdiction of the subject matter of the action attempted to be averred by both complaints.

2. Absent jurisdiction of the subject matter, the "long arm" service provisions (80a-43) of the Act are inapplicable, and jurisdiction cannot be obtained by service out of the District on non-resident defendants.

Greensfelder, Hemker & Wiese, By Forrest M. Hemker, Attorneys for Appellants J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, Suite 1212 —705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

IN UNITED STATES DISTRICT COURT

CERTIFICATE OF SERVICE OF DESIGNATION AND STATEMENT OF POINTS ON APPEAL IN NOS. 59 CIVIL 162 (3) AND 279 (3) —Filed August 23, 1960

Forrest M. Hemker, of lawful age, being duly sworn on his oath, states that he caused to be mailed a copy of the

attached Designation of Record on Appeal of J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jeffer-
[fol. 36] son J. Rebstock and Earl R. Rice to the United States Court of Appeals for the Eighth Circuit, and a copy of Statement of Points upon Which Appellants J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice Intend to Rely on Appeal to all of the attorneys of record in the above entitled consolidated cause on the ..... day of ....., 1960:

R. Walston Chubb, F. A. Maxeiner, Robert S. Allen and Lewis, Rice, Tucker, Allen and Chubb, 1555 Railway Exchange Building, 611 Olive Street, St. Louis 1, Missouri, Attorneys of record for plaintiff, Managed Funds, Inc.

Lon Hocker and Hocker, Goodwin & MacGreevy, 411 N. Seventh Street, St. Louis 1, Missouri, Attorneys of record for defendants, Slayton Associates, Inc., Slayton & Company, Inc., Mutual Fund Distributors, Inc., Hilton Slayton and Hovey E. Slayton.

Richmond C. Coburn and Coburn & Croft, 411 North Seventh Street, St. Louis 1, Missouri, Attorneys of record for defendants, Harold W. Smith and Model, Roland & Stone, a co-partnership.

Cobbs, Armstrong, Teasdale & Roos and William H. Webster, Attorneys of record for defendant, Robert Hicks, 506 Olive Street, St. Louis 1, Missouri.

Dubail, Judge & Kilker, 317 North 11th Street, St. Louis 1, Missouri, Attorneys of record for defendant, Edwin J. Cunningham.

Lloyd E. Boas, defendant, 901 Washington Avenue, St. Louis 1, Missouri.

Bartlett, Muldoon, Stix and Bartlett and William Stix, 506 Olive Street, St. Louis, Missouri, Attorneys of Record for defendants, George H. Shields III and Jacob Baker.

Robert O. Hetlage, 407 North Eighth Street, St. Louis, Missouri, Attorney of record for defendant, James S. Stubbs.

W. Munro Roberts, Jr., 506 Olive Street, St. Louis 1, Missouri, Attorney of record for defendant, Charles E. Brown.

[fol. 37] Irving Norris, 800 North American Building, Wilmington, Delaware, Attorney of record for plaintiff, Emanuel Josephson.

Biggs, Hensley, Curtis and Biggs and Davis Biggs, 319 North Fourth Street, St. Louis 2, Missouri, Attorney of record for plaintiff, Protective Casualty Insurance Company.

Forrest M. Hemker,
Forrest M. Hemker.

Subscribed and sworn to before me this ..... day of August, 1960.

My commission expires: .....

.....
Notary Public.

Greensfelder, Hemker & Wiese.

In United States District Court for the
Eastern District of Missouri
Eastern Division
Civil Action No. 59 C 162 (3)

Managed Funds, Incorporated, Plaintiff,

vs.

Slayton Associates et al., Defendants.

Notice of Appeal of Jacob Baker and George H. Shields, III, in No. 59 Civil 162 (3)—Filed August 12, 1960

Notice is hereby given that Jacob Baker and George H. Shields, III, defendants in the above-entitled case, hereby

appeal to the United States Court of Appeals for the [fol. 38] Eighth Circuit from the order of the Honorable Randolph H. Weber entered July 1, 1960, denying their motions to dismiss.

Bartlett, Muldoon, Stix & Bartlett, By Daniel Bartlett, Jr., Attorneys for Appellants, Jacob Baker and George H. Shields, III, 506 Olive Street #1211, St. Louis 1, Missouri, Ga 1-2950.

In United States District Court

Relevant Docket Entries in U. S. District Court in No. 59 C 162 (3)

1959

Dec. 3 Motion of George H. Shields, III, appearing specially by his atty. for the purposes of this motion only, to dismiss as to said deft., filed.

Dec. 8 Motion of Jacob Baker (appearing specially and not generally) for leave to dismiss amended complaint, with attached supporting affidavit of movant's attorney, as well as request for time to file memo. in support of motion & for oral argument thereafter, filed.

Dec. 28 Motion of deft. Edwin J. Cunningham to dismiss filed. Oral argument requested. Certificate of service of aforesaid motion filed.

1960

Jan. 8 Motion of defendant Cha es E. Brown to dismiss Cts. I, II, III & IV of plaintiff's amended complaint for lack of jurisdiction over the subject matter, with request for oral argument on said motion, filed.

Jan. 11 Motion of deft. Robert A. Hicks to dismiss filed by leave. Oral argument requested.

[fol. 39]

IN UNITED STATES DISTRICT COURT

RELEVANT DOCKET ENTRIES IN U. S. DISTRICT COURT IN No. 59 C 279 (3)

1960

Jan. 29 Order filed sustaining application of Protective Casualty Ins. Co., a corp., for leave to intervene herein and said corp. is permitted to intervene for the purpose of re-alleging & asserting such relief as sought by the pltff., for joinder of additional parties-defts, but not for the purpose of seeking appointment of a receiver; directing aforesaid intervenor's supplemental complaint heretofore lodged shall continued as lodged, not filed & granting said movant 20 days within which to file a supplemental complaint in accordance with order herein, etc.

Apr. 19 Separate motions (1) of defts W. Munro Roberts, Jr., James J. Mullen, Jr., & J. John Brouk; (2) Jefferson J. Rebstock and (3) Earl R. Rice to dismiss the supplementary complaint of Intervenor, Protective Casualty Ins. Co., and to quash service thereof, and separate supplementary motions of aforesaid defts to dismiss pltff's complaint, together with supporting brief, filed. Certificate as to service filed.

[fol. 40]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

September Term, 1959

Appeal from the United States District Court
for the Eastern District of Missouri

J. JOHN BROUK, JAMES J. MULLEN, JR., W. MUNRO ROBERTS, JR., JEFFERSON J. REBSTOCK and EARL R. RICE; EDWIN J. CUNNINGHAM; JACOB BAKER and GEORGE H. SHIELDS, III; CHARLES E. BROWN; and ROBERT A. HICKS, Appellants,

No. 166566 vs.

MANAGED FUNDS, INCORPORATED, a Corporation, EMANUEL JOSEPHSON and PROTECTIVE CASUALTY INSURANCE COMPANY.

ORDER GRANTING APPLICATIONS OF J. JOHN BROUK ET AL., FOR LEAVE TO APPEAL—August 5, 1960

The applications of J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock, Earl R. Rice, Edwin J. Cunningham, Jacob Baker, George H. Shields III, Charles E. Brown and Robert A. Hicks, for leave to appeal under 28 U. S. C., § 1292 (b) from an order of the District Court denying the motion of each of them to dismiss the actions of Managed Funds, Incorporated vs. Slayton Associates, Inc.; and Josephson vs. Slayton et al., Nos. 59-C-162 (3) and 59-C-279 (3), in the District Court for the Eastern District of Missouri, on the ground of lack of jurisdiction, having been duly heard and considered—

It Is Hereby Ordered that said applications be and hereby are granted, and the applicants will be allowed to take such an appeal consolidatedly on the question of the correctness of the Court's ruling on the question of juris-

diction as related to the claims asserted against applicants and the denial made of their motions to dismiss on this basis.

August 5, 1960.

[fol. 41]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 16,566

Appeal from the United States District Court
for the Eastern District of Missouri

J. JOHN BROUK, JAMES J. MULLEN, JR.,
W. MUNRO ROBERTS, JR. et al., Appellants,

—vs.—

MANAGED FUNDS, INCORPORATED, et al., Appellees.

OPINION—January 13, 1961

Before Woodrough, Van Oosterhout, and Matthes, Circuit Judges.

WOODROUGH, *Circuit Judge*:

These appeals are taken from an order of the District Court which denied motions made by appellants to dismiss for lack of jurisdiction of subject matter or person or both in two actions brought against appellants and others by Managed Funds Incorporated and by one Emanuel Josephson. The actions had been consolidated and the order determined that the motions to dismiss the complaints for want of jurisdiction involved a controlling question of law upon which there is a substantial ground for dif-
[fol. 42] ference of opinion and that an immediate appeal from the Court's order may materially advance the ultimate determination of the litigation. Pursuant to application to this Court to appeal under Section 1292(b), 28

U.S.C.A., the appeals were allowed to review the District Court's ruling on the motions to dismiss as related to the claims asserted against these appellants and the denial of appellants' motion to dismiss on jurisdictional grounds.

The plaintiff Managed Funds Incorporated, is a registered open end investment company within the purview of the Investment Company Act of 1940 (54 Stat. Sec. 798-847; 15 U.S.C.A. 80(a) et seq.). Prior to the commencement of the present actions a stop order proceeding was had against it before the Securities and Exchange Commission under Section 8(d) of the Securities Act and a stop order was issued by the Commission upon extensive findings. In re Managed Funds Inc. Par. 76,662, C. C. H. Federal Securities Law Reporter, Current.

The general object and nature of the present consolidated actions is an accounting, injunction and recovery of money damages by Managed Funds for alleged violations of the Investment Company and the Investment Advisers Act of 1940 which are in general the same violations found by the Commission.

The *Josephson* case is a stockholders' derivative action prosecuted for and on behalf of Managed Funds, Inc., but in which Managed Funds, Inc., is named as a defendant. The *Managed Funds* case is a direct action by the corporation itself embracing the same general factual background.

Emanuel Josephson filed the derivative action in the United States District Court, District of Delaware. Man-[fol. 43] aged Funds, Inc., filed its action in the United States District Court, Eastern District of Missouri.

Defendants, Hilton H. Slayton and Hovey E. Slayton, were officers and directors of the fund and owned or controlled defendant, Slayton Associates, Inc., the Funds' Investment Adviser and defendants, Slayton and Company, Inc. and Mutual Fund Distributors, Inc. which were engaged in the selling of Funds' shares. Defendant, Model, Roland & Stone, is a stock brokerage partnership composed of the individual defendants indicated. These appellants and defendants, Boas, Cunningham, Hicks, Jester, Shields and Stubbs are former members of the Board of Directors of Managed Funds, Inc.

The Josephson complaint rests jurisdiction on the claimed violation of the Investment Company and Adviser's Act of 1940, and rules of the Securities and Exchange Commission promulgated thereunder. Managed Funds' Amended Complaint rests jurisdiction on alleged violations of the Investment Company Act of 1940 and rules of the Securities and Exchange Commission promulgated pursuant to it.

Appellant, Jefferson J. Rebstock, and appellant, Earl R. Rice, are citizens and residents of the State of Louisiana. They appeared specially and by motions sought dismissal of the four counts of Funds' amended complaint for lack of jurisdiction of both subject matter and person. Appellants, W. Munro Roberts, Jr., J. John Brouk and James J. Mullen, Jr., are citizens and residents of the State of Missouri. They moved to dismiss for lack of jurisdiction of subject matter. Like motions were filed respecting the Josephson complaint and the adoption thereof by Protective Casualty Insurance Company. Similar motions were filed by all appellants on this appeal.

[fol. 44] These appellants and some other directors are denominated by Fund in the Amended Complaint as "outside directors", that is directors alleged to have had actual or constructive knowledge of the alleged wrongful acts of the Slaytons individually and the Slayton Companies and broker defendants.

The facts pleaded in Count I of Funds' Amended Complaint are substantially as follows:

That the plaintiff, Managed Funds, Incorporated, is a registered open end investment company under the Investment Company Act selling its shares to the general public through underwriters, distributors, dealers and salesmen. That Fund entered into a contract with Slayton Associates, Inc., whereby it became "Funds' Investment Adviser" for agreed compensation of ½ of 1% of the asset value of Funds' asset portfolio, consisting of shares of common stock of various companies. That in December of 1953, Slayton Associates, Inc. employed defendant, Jaquith, as investment counselor and manager of Funds' securities portfolio and delegated its duties as investment adviser to defendant, Jaquith; that Slayton Associates, Inc., agreed to pay Jaquith, $50,000.00 a year for five

years beginning in December of 1953, and a minimum of $35,000.00 a year for the next succeeding five years, which payments were to be applied against brokerage commissions Jaquith or his designees would receive respecting Funds' brokerage business channeled to Jaquith; that Jaquith channeled Funds' business to the stock brokerage partnership of Model, Roland & Stone, defendant herein, of which Jaquith was a member, whereby such partnership received brokerage commissions of over $1,500,000.00; that Jaquith and Model, Roland and Stone paid $50,000.00 a year to defendants Smith and Stubbs, for which no ser- [fol. 45] vices were performed, it being averred that Stubbs is a former business associate of the Slaytons and an employee and representative of Model, Roland and Stone, a former director of the Fund; that defendant, Smith, is also an employee and representative of defendant, Model, Roland and Stone, and a brother-in-law of defendant, Hovey E. Slayton.

That Funds' announced policy in offering its shares as contained in reports and prospectuses filed with the Securities and Exchange Commission was to provide for capital growth and reasonable income consistent therewith by realized profits on the sale of portfolio securities and dividends; and to make quarterly distributions to its shareholder; that after the arrangement with Jaquith, it is averred this policy was not followed, and distribution to shareholders were made of a predetermined income to meet which it was required that capital gains be realized, thereby permitting defendants, Slayton and Company, Incorporated, and Mutual Fund Distributors, Incorporated to make greater commissions and profits from the sale of Funds' shares. This policy, it is averred, resulted in mismanagement, loss and damage to Funds' investment portfolio by increased brokerage commissions for purchase and sale of portfolio securities and greater payments to Jaquith by Slayton Associates, Inc.; that Fund was caused to place its brokerage business for the sale of portfolio securities with brokers who also sold Funds' shares, and with brokers who rendered services to Slayton Associates, Inc., and to Slayton and Company, Inc., and Mutual Fund Distributors, Inc. seller and distributor of Funds' shares

to satisfy obligations of companies for services rendered to them.

By paragraph 21 of Count I of the Funds' amended petition, it is averred that:

> [fol. 46] "The defendants committed, or with actual or constructive knowledge, as herein above set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940."

by (a) operating the fund in the interest of directors, etc., rather than Funds' security holders, [15 U.S.C.A. 80a-1 (b)2] caused Fund to publish and circulate documents containing untrue statements or omitting material facts, [15 U.S.C.A. 80a-33]; (c) caused Fund to deviate from a fundamental investment policy, [15 U.S.C.A. 80a-13] and (d) that defendants, Model, Roland and Stone and Jaquith, acted as investment advisers without a written contract approved by the outstanding voting securities of Fund. [15 U.S.C.A. 80a-15(a)]

Count II of Funds' Amended Complaint avers that the Court has jurisdiction of Count II because it is based on the same acts alleged in Count I of which the Court has jurisdiction under the Investment Company Act. And it is averred that Fund may be liable to purchasers of its shares by reason of the defendants having caused Fund to file false registration statement required by the Securities Act of 1933; that the Securities and Exchange Commission issued a stop order and that Funds' name and good will were damaged, and that Fund expended money for counsel fees and other expenses in connection with the Securities and Exchange proceedings.

Count III bases jurisdiction on the same grounds as Count II and avers that Slaytons individually occupied a fiduciary relationship with Fund as Funds' President and Vice-President; that Model, Roland and Stone and Jaquith acted as investment advisers and therefore occupied a fiduciary relationship; that each of the other defendants had actual knowledge of the fiduciary relationship of the [fol. 47] Slaytons to the Fund, and constructive knowledge of the fiduciary relationship of Model, Roland and Stone

and Jaquith to the Fund; that the Slaytons and Model, Roland and Stone breached their fiduciary duties, committed waste and mismanaged Fund, and all except for the "outside directors" profited thereby; that all defendants, including the "outside directors" by reason of actual knowledge or constructive knowledge of the fiduciary relationships of the Slaytons and Model, Roland and Stone to Fund are liable for their acts.

Count IV adopts the allegations of Count I except paragraphs 20, 21 and 22 and paragraphs 3 through 6 of Count III, and avers a conspiracy between all defendants, except the "outside directors" who, it is averred, had actual or constructive knowledge and failed to do anything to prevent the actions of the other defendants, and are therefore liable to Fund.

Prayer of each of the Counts is for money damages, and for an accounting for profits as to all defendants.

The Josephson complaint recites the same basic facts as Count I of Funds' Amended Complaint and the same violations by Fund, and avers that "the wrongful acts herein described have been and continue to be committed by the defendants against Managed Funds in breach of legal and fiduciary obligations that are inherent by reason of the relationship of the parties". Josephson prays for an injunction in addition to an accounting and damages.

The District Court of Delaware transferred the *Josepson* case to the United States District Court, Eastern District of Missouri and the cases were consolidated.

Pursuant to an order entered by the District Court, the Protective Casualty Insurance Company, a corporation, [fol. 48] was allowed to intervene as a party plaintiff in the *Josephson* case. The Protective Casualty Insurance Company, as an intervening party, adopted the complaint of Emanuel Josephson as its complaint.

On July 1, 1960, the District Court, by its order, denied each and all of the appellants motions to dismiss for lack of jurisdiction of subject matter and or person.

The points presented by appellants for reversal of the order are: 1. That the Investment Company Act of 1940 does not expressly or by implication create any statutory duty or liability respecting directors of an investment

company, the violation of which gives rise to a cause of action by such investment company against these directors which is within the jurisdiction of the District Court of the United States. 2. Mere violations of the federal statute does not as a matter of general law create a case of which Federal Courts have jurisdiction and the theory of federal jurisdiction by implication has been rejected in security cases where corporations have sought to hold directors for claimed statutory violations and mismanagement or breach of duty. 3. The legislative history of the Investment Company Act of 1940 discloses a complete lack of congressional intent to create a body of federal law respecting liability of directors of investment companies.

In support of the first point appellants recall that the Federal Courts are not courts of general jurisdiction but are courts of special or limited jurisdiction in that they have no jurisdiction except that conferred by the Constitution and laws of the United States, 54 Am. Jur. United States Courts Sec. 10, p. 671 and that;

> "A suit to enforce a right which takes its origin in the laws of the United States is not necessarily, or for that reason alone, one arising under those laws, for a [fol. 49] suit does not 'arise' unless it really and substantially involves a dispute or controversy respecting the validity, construction or effect of such a law, upon the determination of which the result depends." *Gully* v. *First National Bank*, 299 U.S. 109, 114.

Appellants point out that neither complaint here involved attempts to base jurisdiction on any federal statute other than the Investment Company Act and the Investment Adviser's Act of 1940 and that the claim of jurisdiction to be sustained must fall within the category of a right created by the act of Congress whereby jurisdiction is conferred upon the Federal Courts without regard either to diversity of citizenship of the parties or the amount in controversy.

The Investment Company Act of 1940, 15 U.S.C.A. 80a-1-52, and the Investment Advisers Act of 1940, 15 U.S.C.A. 80b-1-21, are the fifth in a series of six Congressional enactments relating to securities. The Securities Act of 1933,

15 U.S.C.A. 77a-77aa, the Securities Exchange Act of 1934, 15 U.S.C.A. 78a-jj, the Public Utility Holding Company Act of 1935, 15 U.S.C.A. 79a-z and the Trust Indenture Act of 1939, 15 U.S.C.A. 77aaa-77bbb each contain express provisions for private civil actions. See, 77k, 77l, 78i(e), 78r, 79p, and 77www. Directors may be sued under 77k. Under 78p(b) insiders profits may be recovered by an "issuer", or if it refuses to sue, through a security holder of an issuer in its name. There are provisions for limitations, joint liability and rights of contribution, 77m, 77k(l), 78aa and 77k. By contrast neither the Investment Company Act nor the Investment Advisers Act of 1940 contain any such provisions. The Investment Company and Advisers Acts neither make any definition of the duties of directors nor provide anywhere that a registered investment company may sue its directors.

[fol. 50] Respecting jurisdiction of the District Courts, the Investment Company Act provides:

"Sec. 80a-43. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders, thereunder. Any criminal proceeding may be brought in the district wherein any Act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in this district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created

by, or to enjoin any violation of, this subchapter and section 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding un- [fol. 51] der this subchapter and section 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, Sec. 44, 54 Stat. 844."

The Advisers Act provides:

"Sec. 80b-14. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceedings may be brought in the district wherein any suit or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business, or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review

as provided in section 225 and 347 of Title 28, and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title II, Sec. 214, 54 Stat. 856."

The jurisdiction section of the 1933 Act, 15 U.S.C.A. 77v, the Public Utility Holding Company Act, 15 U.S.C.A. 79y, and the Trust Indenture Act, 15 U.S.C.A. 77vvv, are substantially the same as 80a-43. The Exchange Act pro- [fol. 52] vides that the United States Courts have "exclusive jurisdiction" to enforce liabilities or duties created by that Act. 15 U.S.C.A. 78aa.

The express wording of the Investment Company Act above is that criminal jurisdiction for violations is exclusively in the District Courts of the United States and civil jurisdiction is concurrently in State Courts and Federal Courts "of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter * * * ". The Advisers Act confers jurisdiction of violations and suits to enjoin violations, and says nothing about duties or liabilities of directors.

The absence of specific language creating civil liability respecting private actions narrows the jurisdictional question presented by this appeal to whether or not directors' liability to registered investment companies which they serve has been created by implication.

Under some of the federal legislation relating to security transactions federal jurisdiction of private actions has been upheld by implying a right of action respecting contracts declared void by the statute and by implying a right of action for damages in tort for violation of the federal statute.

Appellants recognize that the doctrine is well supported that a cause of action within the federal jurisdiction exists by implication in the security field in suits brought by purchasers of securities against sellers or by sellers

against purchasers on account of violations more particularly under the 1933 and 1934 Acts. The record of the development of the doctrine is shown in the Annotation to [fol. 53] *Fratt* v. *Robinson*, 203 F.2d 627, (1953) in 37 A.L.R. 2d 649 and it appears that the jurisdiction has been implied first under the general provisions of the Exchange Act, the Holding Company Act and the Investment Company and Investment Advisers Act to the effect that contracts in violation of the Acts or rules thereunder are void. The applicable Investment Company Act provision is as follows:

"Section 80a-46. Validity of contracts.

(a) Any condition, stipulation or provision binding any person to waive compliance with any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title 11, Sec. 47, 54 Stat. 845."

The second basis of liability, is "the common law tort doctrine of private action based on violation of a statute". [fol. 54] It is the position of appellants that the void con-

tract theory of liability and the theory of tort liability based on violation of a federal statute has been rejected by the courts in situations where director liability to their corporation has been involved. Further, that the legislative history of the Acts here involved shows a complete absence of any legislative intent to create such private actions against directors by investment companies cognizable in the Federal Courts.

The appellants refer to the case of *Kardon* v. *National Gypsum Co., et al.* (D.C.E.D. Pa., 1946), 69 F.Supp. 512, as the root case containing judicial pronouncement of the two theories on which federal jurisdiction has been implied.

This was a fraud case under the Exchange Act of 1934 to recover damages against the National Gypsum Company and others for inducing plaintiffs to sell their stock in two corporations for less than true value. The court was ruling on motions of defendant to dismiss for lack of jurisdiction of person and failure to state a claim. By Rule X-10B-5 implementing 78j, the Security Exchange Commission made it unlawful for any person to employ deceptive devices in the purchase or sale of securities. The Court stated the question was whether the conduct complained of gave rise to a liability or involved a breach of duty created by the 1934 Act and then held:

> "It is not, and cannot be, questioned that the complaint sets forth conduct on the part of the Slavins directly in violation of the provisions of Sec. 10 (b) of the Act and of Rule X-10B-5 which implements it. It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the [fol. 55] Rule. However, 'the violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. * * * '. Restatement, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory

> interpretation. The disregard of the command of a statute is a wrongful act and a tort."

The court also predicated liability on the void contract-theory saying:

> "Apart from Sec. 10 (b), I think that the action can also be grounded upon Sec. 29 (b) of the Act which provides that contracts in violation of any provision of the Act shall be void. Here, unlike the point just discussed, the question is purely one of statutory construction. It seems to me that a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences. Beyond this, however, as pointed out by Judge Coxe in *Geismar* v. *Bond & Goodwin, Inc.*, D.C., 40 F.Supp. 876, 878, the 1938 amendment which deals in part with actions 'maintained in reliance upon this subsection' clearly contemplates that Congress meant the original statute to be interpreted as providing for civil suits under it. And, as he further pointed out, such suits would include not only actions for rescission but also for money damages."

It is significant that in speaking of the void contract theory the court says a *party* may be relieved of contract obligations induced by violations and appellants insist that the Security Act provisions voiding contracts in violation [fol. 56] of the Acts can apply, only where plaintiff and defendant in an action for relief under the Acts are in privity of contract or perhaps where plaintiff can work out a third party beneficiary relationship. None of appellants here are parties to the advisory contract between Associates and Fund or the contract between Associates Jaquith and Model, Roland and Stone. They say they can not be brought within the doctrine of *Kardon* v. *National Gypsum Co. et al.*, supra. Furthermore, that the defendants in the action were the ones charged with violating the Acts was conceded in

Kardon, whereas appellants contend the complaints here charged no statutory duties or liabilities respecting directors which these directors have violated.

2.

Under their second point appellants contend that the courts have rejected implication of federal jurisdiction in director liability cases. They cite *Howard* v. *Furst* (2d Cir. 1956), 238 F.2d 790, aff'd, S.D.N.Y. 140 F.Supp. 507. That was a derivative suit on behalf of Circle Wire & Cable Corporation against officers and directors of Circle who held over 60% of Circle's shares. There was no diversity. Federal jurisdiction was asserted under the Exchange Act of 1934, Section 78aa. The complaint alleged that Circle had an agreement to sell and a Cerro de Pasco Corporation an agreement to buy Circle's property and business for over twenty million dollars; that the individual defendants to advance their own private interest negotiated the sale for less than the value of the assets of Circle; that the sale would constitute a waste of Circle's assets; that the directors by virtue of their position and as controlling stockholders of Circle abused their fiduciary obligations. That a proxy statement of Circle's share-[fol. 57] holders meeting to vote upon the sale was false and misleading, in that it understated the cost and value of Circle's inventory and its earnings and failed to disclose the private interests of the officers and directors of Circle. Section 78n (a) made it unlawful to solicit proxies by use of the mails in contravention of rules of the S.E.C. and by Rule X-14A-9 the S.E.C. had proscribed false or misleading material in proxy statements. The prayer for relief was to declare the proxies void; to enjoin certain individual defendants from voting, to declare the sale contract void, and to rescind it and restore the status quo and alternatively, if this be impossible, that Circle recover damages from Cerro and the individual defendants directors of Circle. In summing up the complaint the Court said; "In other words, appellant asserted a claim for an injunction against the sale, which, now that the sale has gone through, has become a claim for rescission or for

the damages suffered by Circle, not by appellant". The Court sustained the action of the District Court, S.D.N.Y. 140 F.Supp. 507, dismissing the complaint for lack of jurisdiction of the subject matter, Circuit Judges Hand, Medina, and Hincks sitting. The Court said:

> "As the case is said to be one 'arising under' the laws of the United States, our first inquiry is addressed to appellant's contention that the statutory provisions above quoted create or give rise to a substantive civil right on behalf of Circle, which may be enforced in a derivative action by an individual stockholder. We reject this contention as unsound. We find nothing in the language of Section 14 (a) or in the legislative history of the Securities Exchange Act of 1934 to warrant an inference that it was the intention of the Congress to create any rights whatever in a corporation whose stockholders may be solicited by proxy statements prepared in contravention of the statutory mandate."

[fol. 58] The Court pointed out that where the 1934 Act created a corporate action for insider profits this was done by an express provision 15 U.S.C.A., Sec. 78p (b). Applying the federal right test of the *Gully* case, supra, the Court said:

> "Applying this test it is clear to us that every essential element of appellant's case depends upon the common law and the statutes of the state of New York. If the individual defendants who controlled 60.68% of Circle's outstanding stock, in violation of their fiduciary duties as directors and officers of Circle, brought about a sale of Circle's assets for a grossly inadequate sum, all in furtherance of their personal and private interests, the case would be ripe for judgment for rescission of the sale or for damages, wholly irrespective of whether some or all of the individual defendants had participated in the formulation and sending out of a false or misleading proxy statement. The allegations with reference to the proxy statement constitute a mere

excrescence or superfluity tacked onto what are otherwise sufficient allegations of a claim for relief under New York law."

Appellants also cite *Downing* v. *Howard*, 162 F.2d 654 (3rd Cir. 1947), aff'd, 68 F.Supp. 6 (D.D.C. 1947). The nature of the action is described by the Court as follows:

> "Plaintiff is the owner of shares of United Corporation (of Delaware), hereafter called United. He brought this action in the United States District Court for the District of Delaware on behalf of himself, other shareholders of United, and the Corporation against individuals or, in some instances, their personal representatives, who had been directors of United and certain other persons alleged by plaintiff to have conspired with the directors to the detriment of the Corporation. Most of the individual defendants are neither residents of Delaware nor engaged in business there. Plaintiff, [fol. 59] however, says that he is properly in the federal court under Sec. 25 of the Public Utility Holding Company Act of 1935. He concedes that unless he has stated a cause of action 'created' by that statute his action in the District Court of Delaware will not lie."

By the third count it was claimed the directors failed to file with the SEC a plan of reorganization. The Court held:

> "The fatal obstacle to the plaintiff's complaint on this score is that the legislation does not require the company to furnish a plan. A cause of action can hardly be based upon disobedience of the statute when the statute does not require the act, the non doing of which is complained of by the plaintiff. Plaintiff's complaint, therefore, as to this cause of action stops at this point so far as it is predicated upon liability under the federal statute."

By the first count it was alleged the directors failed to register United and that while United was unregistered it

held securities which depreciated $87,000,000.00. The Court held there was no duty on a registered company to sell its securities, hence failure to register had no legal connection with the loss. Count two, also based on failure to register averred that an option exercised by directors which turned out to be a bad guess would not have happened if United was registered. The Court said:

> "Plaintiff's theory is that if United had refrained from voting and exchanging as required by Sec. 4 (a) (6), 4 (a) (3), and 4 (a) (4) of the Act, there would have been no loss since the consolidated preferred has maintained its market value and all accumulated dividends have been paid . . . Plaintiff does not allege, and we do not know, what would have happened with regard to this exchange of shares had United been registered and all the facts which a registration re- [fol. 60] quires had been brought out. Even if the plaintiff had alleged that the exchange would never have taken place if United had been registered the complaint would still stop short of being legally sufficient unless it stated facts showing that the loss suffered happened in a way the statute was enacted to prevent. This he failed to do. We do not think, therefore, that what plaintiff complains of was occasioned either by owning or exchanging unless, as discussed above, the statute violator is to be held to complete insurer's liability."

District Judge Leahy in dismissing the *Downing* case below summarized his views as follows:

> "Clearly, then, the suit at bar is not a 'suit in equity • • • brought to enforce any liability or duty created' by the Act. Absent other jurisdictional elements, a minority stockholder may not resort to the federal courts on simple allegations that directors and officers, with other coconspirators, have violated federal statutes—such as anti-trust laws and the Interstate Commerce Act, 49 U.S.C.A. Sec. 1 et seq.—in addition to committing breaches of fiduciary duty." 68 F.Supp. at 10.

Birnbaum v. *Newport Steel Corporation*, 193 F.2d 461, (2d Cir., 1951) is also cited. There the Second Circuit had before it a suit brought on behalf of the Newport Steel Company by shareholders alleging jurisdiction under the Securities Exchange Act of 1934, 15 U.S.C.A. 78aa. Violation of fiduciary obligations by directors was pleaded in selling their stock in Newport and making fraudulent reports to Newport's stockholders. It was claimed S.E.C. Rule X-10B-5 was violated. The Court held that the claimed violations had no relation to breach of fiduciary duties by corporate insiders which resulted in fraud upon stockholders who were neither buyers nor sellers (the protected class under the 1933 and 1934 Acts).

[fol. 61] The Court rejected plaintiff's contention that the rule supplemented the common law liability of those who abuse the trust of their corporate positions and created a federal case and said:

> "But the appellants argue that such an interpretation of the Rule is too narrow to carry out the broad purpose of the Act to protect investors 'from exploitation by corporate insiders'. * * * We do not doubt that Congress was at least partially motivated by such a purpose in enacting the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78a et seq. However, the precise question here is whether Section 10(b) of the Act and the Commission's Rule X-10B-5 were the means chosen to further that end, and we are of the opinion that the legislative 'history' and 'purpose' quoted by appellants are not persuasive that they were. When Congress intended to protect the stockholders of a corporation against a breach of fiduciary duty by corporate insiders, it left no doubt as to its meaning.[1]

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[1] We observe that when Congress intended to create a federal case of director liability it made its meaning clear. The National Banking Act provides that directors of a National Bank who knowingly permit any of the officers, agents or servants of the association to violate any provisions of the Act, every director who participated in or assented to the same is to be held liable in his personal and individual capacity for all damages which the association, its shareholder or any other person shall have sustained in consequence of such violation 12 U.S.C.A. Section 93.

Thus Section 16 (b) of the Act of 1934, 15 U.S.C.A. Sec. 78p (b) a right of action against corporate insiders using their position to profit in the sale or exchange of corporate securities. The absence of a similar provision in Section 10 (b) strengthens the conclusion that that section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller. Since the complaint failed to allege that any of the plaintiffs fell within either class, the judgment of the district court was correct and is accordingly affirmed."

[fol. 62] The appellants then cite non-security cases illustrating lack of federal jurisdiction when none is legislatively conferred as follows:

Meyer et al. v. *Kansas City Southern Railway Company* (2 Cir. 1936), 84 F.2d 411, stockholders derivative action for conspiracy against railroads and directors alleged violation of antitrust laws;

Jacobson v. *New York, N. H. & H. R. Co.* (1 Cir. 1953), 206 F.2d 153, violation of Safety Appliance Acts;

Consolidated Freightways v. *United Truck Lines* (9 Cir. 1954), 216 F.2d 543, violation of Motor Carrier Act;

Miller v. *Long* (4 Cir. 1945), 152 F.2d 196, violation of National Housing Act;

Republic Pictures Corp. v. *Security First National Bank* (9 Cir. 1952), 197 F.2d 767, case involving mortgage on a copyright;

State Automobile Ins. Ass'n v. *Parry* (8 Cir. 1941), 123 F.2d 243;

Note: 14 A.L.R. 2d 992—What actions arise under the laws and treaties of the United States so as to vest jurisdiction of Federal Courts.

3.

As to the lack of congressional intent to create a body of federal law respecting liability of directors of invest-

ment companies. Such review as we have been able to make of the legislative history has afforded little assistance either in justifying or refuting the implication of a private right of suit such as claimed here. Senate and House Committees reports are devoid of clear reference to civil liability except with respect to provisions expressly imposing it. We are cited to the analysis of the Investment Company Act of 1940 in 50 Yale L. J. 441, 446, that "the original draft of [fol. 63] the section" (now 15 U.S.C.A. 80a-9) "which required all investment company officers and directors to register as individuals with the S.E.C. and become subject to such disqualification as that body should propose drew a storm of protest from the industry." As passed, the director registration requirement was deleted. The original bill had further provided that if any person registered under the Act was guilty of gross misconduct or gross abuse of trust he would be guilty of a crime. This provision was omitted from the Act. The note in the journal continued by saying, that: "It was suggested during the hearings on the original bill that this whole problem" (managerial responsibility) "could be solved most expeditiously by declaring investment company managements to be trustees in fact with trustee obligations to their stockholders." This proposal, however, which would have involved drastic managerial responsibility, was rejected except to the extent that "gross abuse of trust" was made a ground for restraining the guilty party from further connection with the industry. The "gross abuse" section referred to is 15 U. S. C. A. 80a-35 and the Securities and Exchange Commission is the one there authorized to bring the action.

Congress did refrain from including in the Acts any control or regulation or expansion of the common law duties of directors of investment companies and the failure to provide any private civil remedies or for joint and several liability or contribution or statutes of limitation such as are found in the 1933 and 1934 Acts indicates that the omission was deliberate. At common law directors are liable to exercise due care and to render them liable by implication on account of violations of the Acts by others would be a drastic innovation.

[fol. 64] Senator Lodge of Massachusetts stated in the Senate on June 21, 1940, in urging the passage of the present Act:

> "It so happens that the investment trust business is one which very largely had its origin in Boston and I happen to know a great many people connected with this industry. • • •
>
> This bill, as the Senator from New York has said, was agreed upon after very painstaking and careful study, in which really almost a miracle occurred, in that all the various elements in the industry were able to get together and organize themselves, and present a common basis for studying the question, and as the result of that effort an agreement which is embodied in this bill was reached between those engaged in the industry and the members of the S.E.C. I submit that that is a very unusual and very beneficial occurrence—."

It seems improbable that there would have been such unanimity for the passage of the Act if it had been thought to impose any such per se liability on directors as is claimed by plaintiffs here. The failure to provide for any private civil remedies or for joint and several liability of directors and persons who commit or contribute to violations or for statutes of limitations or for conditions is persuasive that the omission was deliberate. Certainly, the Courts will imply a liability only to implement a manifest legislative intent. The enactments as they stand do not justify implications that jurisdiction was intended to be conferred.

The appellees in support of the jurisdiction and the ruling appealed from contend that the facts alleged in the complaints state a claim upon which the Investment Company Act of 1940 provides a remedy to Managed Funds and against appellants in the Federal District Court. They [fol. 65] have cited and relied on the following provisions of the Act and texts and decisions:

Alfred Inv. Trust et al. v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945)

Alleghany Corporation v. *Breswick & Co.*, 353 U.S. 151 (1957)
Baird v. *Franklin*, 141 F.2d 238 (2d Cir., 1944)
Bell v. *Hood*, 327 U.S. 678 (1945)
Birnbaum v. *Newport Steel*, 193 F.2d 461 (2d Cir., 1951)
Brandt v. *Renfield*, 278 F.2d 904 (8th Cir., 1960)
Breswick & Co. v. *United States*, 134 F.Supp. 133 (S.D.N.Y., 1955), 138 F.Supp. 123 (1956)
Breswick & Co. v. *Briggs*, 135 F.Supp. 397 (1955)
Cogan v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y., 1958)
Collings v. *Busch Manufacturing Co.*, 19 F.R.D. 297, (S.D.N.Y., 1956)
Downing v. *Howard*, 68 F.Supp. 6 (D. Del. 1946) 162 F.2d 654 (3d Cir., 1947)
Errion v. *Connell*, 236 F.2d 447 (9th Cir., 1956)
Fielding v. *Allen*, 181 F.2d 163 (2d Cir., 1950)
Fischman v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951)
Fratt v. *Robinson*, 203 F.2d 627 (9th Cir., 1953)
Goldstein v. *Groesbeck*, 142 F.2d 422 (2d Cir., 1944)
Gully v. *First National Bank in Meredian*, 299 U.S. 109 (1936)
Hawkins v. *Merrill Lynch, Pierce, Fenner & Beane*, 185 F.Supp. 104 (W.D.Ark., 1949)
Hooper v. *Mountain States Securities Corporation*, Par. 90,972, C.C.H. Federal Securities Law Reporter.
Howard v. *Furst*, 238 F.2d 790 (2d Cir., 1956)
Hurn v. *Oursler*, 289 U.S. 238 (1933)
R. H. Johnson & Co. v. *S.E.C.*, 198 F.2d 690 (2d Cir., 1952)
Jung v. *K & D Mining Co.*, 260 F.2d 607 (7th Cir., 1958)
Kardon v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D.Pa. 1946), 73 F.Supp. 798 (1947)
[fol. 66] *In re Managed Funds, Incorporated*, Par. 76,662, C.C.H. Federal Securities Law Reporter, Current.
Schwartz v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y. 1957)
Schwartz v. *Eaton*, 264 F.2d 195 (2d Cir., 1959)

Slavin v. *Germantown Fire Ins. Co.*, 174 F.2d 799 (3rd Cir., 1949)
Sparks v. *England*, 113 F.2d 579 (8th Cir., 1940)
Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957)
Stella v. *Kaiser*, 82 F.Supp. 301 (S.D.N.Y., 1948)
Taussig v. *Wellington Fund, Inc.*, Par. 90,979, C.C.H. Federal Securities Law Reporter, Current 187 F.Supp. 179, (D. Del., 1960)

Statutes Cited:

79j (Rule X-10B-5), 78aa, 78p of Title 15, U.S.C.A., 79y, 79z of Title 15, U.S.C.A.
80a-1 (b) of Title 15, U.S.C.A.
80a-2 (a) (19) of Title 15, U.S.C.A.
80a-8 (b) of Title 15, U.S.C.A.
80a-10 of Title 15, U.S.C.A.
80a-13 (a) (3) of Title 15, U.S.C.A.
80a-15 of Title 15, U.S.C.A.
80a-16 of Title 15, U.S.C.A.
80a-33 of Title 15, U.S.C.A.
80a-43 of Title 15, U.S.C.A.
80a-46 (b) of Title 15, U.S.C.A.
80a-47 of Title 15, U.S.C.A.

Rules Cited:

Rule 8a Federal Rules of Civil Procedure.

Texts Cited:

Congressional Record, 1940, P. 10074
Green, George Washington Law Review, Vol. 28
Jaretski, 26 W.U.L.Q. 303
61 Harvard Law Review 858
Report of Hearing of H.B. 100065, Subcommittee of Committee of Interstate and Foreign Commerce (76th Congress, 3rd Session)
[fol. 67] Restatement of the Law of Torts, Section 286
Senate Report No. 1775, 76th Congress, 3rd Session June 6, 1940.

In the first place, the appellees stress the decision in the *Kardon* case, supra, and the fact that the Court there found federal jurisdiction by implication both because the defendant had violated a legislative enactment causing damage to plaintiff and because the statute declared that the contract so obtained in violation "shall be void". We do not express disagreement in any respect with the *Kardon* decision and others in accord with it. In *Kardon* the party damaged by a contract obtained in violation of a federal law, which contract the law made void, was allowed to sue in federal court the party who offended and profited. But we do not hold the situation here to be analogous.

Goldstein v. *Groesbeck*, 142 F.2d 422, (2d Cir., 1944) involved a void contract under the Holding Company Act. Defendant, Electric Bond & Share, was the top holding company and through American Power & Light it controlled four power companies. It had construction contracts with the power companies and caused the contracts to be taken over by corporations organized by it. By the Act it was unlawful for an unregistered holding company to enter into construction or service contracts with public utilities. Goldstein brought the action as a shareholder of American derivatively for American and the controlled power companies to compel an accounting for profits gained by the construction and service corporations and certain of their officers and directors. The court decided that but for the Act the payment under the contracts would have been lawful, therefore, "the words 'any liability or duty' are clearly broad enough to include any [fol. 68] breaches of duty causing injury or loss to private persons." The void contract theory is enunciated as follows:

> "As we have seen, the Act makes it unlawful for unregistered holding companies to enter 'directly or indirectly' into service or construction contracts . . .
>
> Violation being thus established, Sec. 26 (b), 15 U.S.C.A. Sec. 79z (b), in express terms declared the contracts void. It should follow that the operating companies are entitled to a refund, for no other result can fulfill the expressed purpose of the Act

of protecting subsidiaries from the overreachings of holding companies. Thus, the statutory declaration of the necessity for control of holding companies in Sec. 1 (b) (2), 15 U.S.C.A. Sec. 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services'. The three specific sanctions stated in the Act—injunction, Sec. 18 (f), 15 U.S.C.A. Sec. 79r (f); criminal punishment, Sec. 29, 15 U.S.C.A. Sec. 79z-3; and the negative relief of Sec. 26 (b), declaring the contracts void- do not in terms place the defrauded operating company in status quo; and Sec. 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies . . .

. . . Furthermore, the analogy of the Securities Exchange Act is again useful. Private enforcement of Sec. 29 (b) of that statute has been permitted, *Geismar* v. *Bond & Goodwin, Inc.*, supra, while we have recently upheld broadly the private rights of action impliedly granted by the Securities Exchange Act, *Baird* v. *Franklin*, 2 Cir., 141 F.2d 238; and cf. *Charles Hughes & Co.* v. *S. E. C.*, 2 Cir., 139 F.2d 434, certiorari denied 64 S.Ct. 781. As we have pointed out in those cases, we think a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

[fol. 69] The case did not involve asserted liability of the directors of Electric Bond & Share to it for causing it, through its controlled construction and service corporation, to enter into the void contracts with the power companies. Goldstein sought an accounting for "profits" made by the directors and the construction and service companies illegally contracting with the operating companies. Electric Bond & Share was a party because it acted through its controlled construction and service corporation. In other words, this was a suit for recovery of the consideration paid by the operating companies under the void contract.

The Court carefully reserves the question of whether the recovery would be for the entire consideration or the excess thereof over the reasonable value of the services rendered. The case illustrates that jurisdiction implied under the void contract theory requires privity and does not hold that directors may be held liable to account to the corporation for return of a consideration which they did not receive.

Referring to *Geismar* v. *Bond & Goodwin, Inc.*, supra, the Court there said:

> "A useful analogy in favor of this interpretation of implied liability can be found in Sec. 29 of the Securities Exchange Act which is virtually identical with Sec. 26 of the Utility Act for it is now clear from the 1938 amendment to Sec. 29, 52 Stat. 1076 that Congress intended a right of recovery thereunder."

The section referred to is 15 U.S.C.A. 78cc (b) and the 1938 amendment is a provision added to the void contract section of the Exchange Act of 1934 reading:

> "Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to para- [fol. 70] graph (2) or (3) of subsection (c) of Section 78o of this title, and (b) that no contract, shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection by any person to or for whom any broker or dealer sells, or buying from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such violation is brought within the year after discovery and within three years after such violation."

Appellees argue that as the corporation acts through its officers and directors such parties in control must be held liable because if the company violates the acts they directly or indirectly cause the violation. They contend

that the directors should be held liable under Section 80a-47 which provides:

"(a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or other thereunder.

"(b) It shall be unlawful for any person without just cause to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, record, or account required to be made, filed, or kept under any provision of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or order thereunder. Aug. 22, 1940, c. 686, Title 1, section 48, 54 Stat. 846."

Section 80a-33 (b) provides:

"(a) It shall be unlawful for any person, except as permitted by rule, regulation, or order of the Commission, willfully to destroy, mutilate, or alter any [fol. 71] account, book or other document the preservation of which has been required pursuant to section 80a-30 (a) or 80a-31 (c) of this title.

"(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter and sections 72 (a) and 107 (f) of Title 11 or the keeping of which is required pursuant to section 80a-30 (a) of this title. It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an ac-

countant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document. Aug. 22, 1940, c. 686, Title 1, section 34, 54 Stat. 840."

Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957) is cited in support. There purchasers of securities which were sold in violation of the 1933 Act sued one Rankin, a Vice-President and director of the corporation, among others and he denied participation. It was a jury question whether he was in "control" within the meaning of section 77a of the Act and under proper instructions the jury's verdict that he was in such control was sustained.

In *Hawkins* v. *Merrill Lynch et al.*, 85 F.Supp. 104 (W.D.Ark. 1949) also cited to the same point. It was held that where the defendant was sued and held liable for sales of securities in violation of the Exchange Act of 1934 directed another in such a manner as to violate the [fol. 72] rights secured by the legislation "there exists that degree of control necessary to create liability under section 78t (a)."

R. H. Johnson & Co. v. *Securities & Exchange Commission*, 198 F.2d 690 (2d Cir., 1952) also cited to the point. But we do not find that either of these three cases lend substantial support to appellees.

The Holding Company Act provision 79z-1 is the same as the Investment Act 80a-47. The Securities Act of 1933 has no comparable section. The Exchange Act of 1934 does have a comparable section 78t (b). Both the 1933 and 1934 Acts have sections making a person controlling any person who is liable under these Acts, jointly and severally liable with the controlled person (77o and 78t). The Investment Company Act has no such provision nor does the Holding Company Act. With respect to controlling persons the Investment Company Act indicates by its definition of "control" that the powers of control which inure to directors solely as the result of their official position in the company are not included in the word

"control" used in respect to provisions in the Act. The definition reads:

> "'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

Appellants insist and we agree that this wording of the Act shows that it was the legislative intent to refrain from entering the field of director responsibility. There is a sense in which it can be said as appellees have argued that directors control the various corporate actions of management on policy, but by this provision directors [fol. 73] acting in their official capacity are excluded from being held liable on that theory. As was stated in *Downing* v. *Howard*, 68 F.Supp. 6, 10, "At best, the alleged violations were violations by United. There is no provision in the Act imposing a duty or liability on officers or directors as such or upon outsiders acting in concert with officers and directors."

Appellees cite *Hooper* v. *Mountain States Securities Corporation*, ... F.2d ... (5th Cir., 1960) which was brought under the 1934 Act to recover on account of a fraudulent scheme concerted by defendants to have shares of stock issued for worthless property in order that the individuals could divide up the stock for their own use and get the benefits of their fraud. The court held the transactions to be within the purchase and sale provisions of the 1934 Act and the regulation. But on its facts the case does not have a bearing on the problem here in issue.

In *Taussig* v. *Wellington Fund, Inc.*, 187 F.Supp. 179 (D.C.Del. 1960) the controversy was between two investment companies both employing the name Wellington, which name was also used by the underwriters and advisors. The Court held the first investment company had the right to use the name Wellington and that use by the other was enjoined. Several provisions of the securities Acts were relied on to confer jurisdiction including 80a-34 (d) which makes it unlawful "for any unregistered investment company to adopt as a part of the name

or title of such company any word or words which the Commission finds and by order declares to be deceptive or misleading". It appeared to the Court that as the federal claim was not frivolous or a sham the Fund had standing to prosecute the action but there was no need to rule substantively on the federal causes.

[fol. 74] In *Aldred Mo. Trust* v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945) the Commission sued under the Investment Company Act to enjoin the officers of an investment trust from continuing to act in such capacity and for the appointment of a receiver under 15 U.S.C.A. 80a-35 commonly referred to as the "gross abuse of trust" section. The case illustrates the instance in which the Act does deal with the matter of directors duty. It creates a right of action against directors to remove them from office for gross abuse of trust but it must be done on the initiative of the Commission. It furnishes no support for the liability of directors which Fund asserts on this appeal. In paragraph 1 and 2 on page 260, the Court refers to provisions of 15 U.S.C.A. Sec. 80a-1 (b) as effecting a codification of the fiduciary obligations imposed upon officers and directors of investment companies but the codification is of duties of the companies and the reference does not support a conclusion that Congress thereby created a federal cause of action in private individuals or by investment companies against their directors.

In *Cogan* v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y. 1958) the plaintiff suing individually and as a stockholder of an investment company which had been deregistered by the Securities and Exchange Commission charged a continuing conspiracy by the company and its officers and directors to violate the 1940 Investment Company Act and with violations of the Act "in numerous ways". The relief sought was injunction against the continuing violations of the Act and injunction against the individual defendants preventing them from combining as officers and directors and for the appointment of a receiver to enable the company to comply with the Act. There was also a charge that the defendants [fol. 75] caused the company to violate the Act for their own interests and were guilty of gross abuse of trust as officers and directors.

The District Court held that the individual stockholders had no standing to bring an action based on the gross abuse of trust section, 15 U.S.C.A. 80a-35. The Court declared however that it did not "appear to a certainty that the plaintiff is entitled to no relief under any state of facts which may be proved in support of his claim" and denied the motion to dismiss.

The appellants say in reference to the *Cogan* case that if the holding there is that directors are liable for the facts of their corporation in violation of the 1940 Act, it is wrongly decided and should not be followed by this Court.

Respecting *Schwartz* v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y., 1957) and related cases of *Breswick & Co.* v. *United States*, 134 F.Supp. 133 (S.D.N.Y., 1955), and *Breswick & Co.* v. *Briggs*, 135 F.Supp. 397 (1955) the federal case in *Schwartz* was violation by the Alleghany Railroad of the Investment Company Act by acquiring the New York Central stock without registering under the Act. The Court on appeal said a joint venture or conspiracy to cause C. & O. and Alleghany to engage in a transaction prohibited by the Act was charged. Appellants stress the contention that "there is a fundamental and critical distinction to be drawn between a case where a director is an actor and joint tort feasor in violating a statute and a case where the asserted liability is predicated upon vicarious liability for allegedly causing the corporation he serves to violate the statute". Because the Investment Company Act does not as do the 1933 and 1934 Acts create a joint duty and liability none can be implied to create a federal case. The [fol. 76] conspiracy in the *Schwartz* and *Breswick* cases distinguish them from the present appeal.

We do not find *Bell* v. *Hood*, 327 U.S. 678 (1945) to be relevant. The intent and effect of the decision as applied to the facts in that case were thoroughly considered by the District Court when the case was returned to it. 71 F.Supp. 813. The claim before the Supreme Court was that defendants had violated specified provisions of the federal law and Constitution. The doctrine of jurisdiction by implication where the federal statute has not imposed a duty was not discussed by the Supreme Court.

The District Court stated the rule it was required to follow, l. c. 820:

> "'Where, as here, neither the Constitutional provision nor any Act of Congress affords a remedy to any person, the mere assertion by a plaintiff that he is entitled to such a remedy' does not constitute a federal cause of action. . . .
>
> "In assuming jurisdiction under mandate of the Supreme Court, this Court is called upon to decide 'the issue of law . . . whether federal courts can grant money recovery for damages said to have been suffered as a result of federal officers violating the Fourth and Fifth Amendments.' . . .
>
> "Being of the opinion that neither the Constitution nor the statutes of the United States give rise to any cause of action in favor of the plaintiffs upon the facts alleged, I hold that federal courts cannot now grant such recovery. Nor does any other ground appear upon which relief can be granted to plaintiffs in this Court."

On consideration of the whole record and citations we conclude the claim stated against these appellants does not support the federal jurisdiction. At common law directors are liable to exercise due care and are not in- [fol. 77] surers, 13 Am. Jur. Corporation Sec. 990, p. 943-944. The complaints here substantially seek to hold these former directors to strict liability as insurers. The Act they rely on not only contains no such provision but plainly negates any intent to create such an innovation. The reliance upon implication to support the jurisdiction is not justified in the face of the legislative intent to exclude it.

In view of the conclusion that the motions for dismissal as to these appellants for lack of jurisdiction of the subject matter of the claim against them should be sustained, we need not discuss the question as to the out of the State service upon appellants, Rebstock and Rice.

Reversed with direction to dismiss the case as to these appellants.

[fol. 78]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 16566—September Term, 1960

J. JOHN BROUK, JAMES J. MULLEN, JR., W. MUNRO ROBERTS, JR., JEFFERSON J. REBSTOCK and EARL R. RICE; JACOB BAKER and GEORGE H. SHIELDS III, Appellants,

—VS.—

MANAGED FUNDS, INCORPORATED, a Corporation, EMANUEL JOSEPHSON and PROTECTIVE CASUALTY INSURANCE COMPANY.

JUDGMENT—January 13, 1961

Appeal from the United States District Court for the Eastern District of Missouri.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Order of the said District Court overruling Motions to dismiss entered July 1, 1960, be, and the same is hereby, reversed with costs; and that J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, have and recover against Managed Funds, Incorporated, a Corporation, Emanuel Josephson and Protective Casualty Insurance Company, the sum of Two Hundred Forty and 65/100 ($240.65) Dollars for their costs in this behalf expended and have execution therefor.

And it is further Ordered by this Court that this cause [fol. 79] be, and it is hereby, remanded to said District Court with direction to dismiss the case as to appellants J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock, Earl R. Rice, Jacob Baker and George H. Shields III.

[fol. 80]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

(Title omitted)

ORDER DENYING PETITION OF APPELLEE FOR REHEARING—March 6, 1961

Appeal from the United States District Court for the Eastern District of Missouri.

The Clerk is directed to file the petition amicus curiae previously lodged by the Securities & Exchange Commission but the right of the Commission to participate as amicus curiae is denied since its application was not timely. The petition of appellee for rehearing has been considered by the Court and is hereby denied.

[fol. 81]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

(Title omitted)

ORDER STAYING ISSUANCE OF MANDATE—March 13, 1961

Appeal from the United States District Court for the Eastern District of Missouri.

On Consideration of the motion of appellee for a stay of the mandate in this cause pending a petition to the Supreme Court of the United States for a writ of certiorari, it is now here ordered by this Court that the issuance of the mandate herein be, and the same is hereby, stayed for a period of thirty days from and after this date, and if within said period of thirty days there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that a petition for writ of certiorari and record have been filed, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

[fol. 82] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 83]

SUPREME COURT OF THE UNITED STATES

No. 947—October Term, 1960

MANAGED FUNDS, INCORPORATED, Petitioner,

vs.

J. JOHN BROUK et al.

ORDER ALLOWING CERTIORARI—June 19, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.